Mobilizing resources for IFAD programmes

Alternative sources and innovative modalities

Summary of the roundtable discussion
12-13 June 2012

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Enabling poor rural people to overcome poverty

IFAD

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List of acronyms

AfDB	African Development Bank
BBI	Bosna Bank International
IDA	International Development Association
IFC	International Finance Corporation
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IsDB	Islamic Development Bank
UN	United Nations
UNDP	United Nations Development Programme

The roundtable discussion on *Mobilizing Resources for IFAD Programmes: Alternative Sources and Innovative Modalities* took place at IFAD headquarters on 12-13 June 2012. The event launched IFAD's exploration of new sources and modalities for mobilizing resources.

The roundtable was intended to help IFAD learn about the experience of other development entities in their efforts to attract alternative financing from public and private sources. It was also meant to shed light on the perspectives and approaches of banks and impact investors involved in development finance and to identify the most promising potential partners and structures for expanding IFAD's collaboration.

More than 50 external participants joined in the event. They represented a wide range of institutions: central banks, ministries of finance, development finance institutions, UN agencies, think thanks, commercial banks and impact investment funds.

For a list of external participants, see the Annex.

Introduction

The majority of the world's poor people live in rural settings, and close to 1 billion of those who make their livelihoods in rural areas subsist on less than US$1.25 per day. Rural children are more likely to suffer from malnutrition than their urban counterparts, and the ecosystems and biodiversity on which rural people rely are increasingly degraded. Enabling rural poor people to sustainably overcome the obstacles that contribute to this persistent poverty and hunger is the core of IFAD's work, and the Fund is obligated to mobilize the resources necessary to carry out this work. Indeed, mobilizing additional, concessional resources for agricultural development in developing countries was the reason IFAD was established in the mid-1970s.

The food price spike of 2007-2008 jolted the international community. It prompted a refocus of global attention on food and nutrition security, especially on support for small-scale agriculture, which is increasingly recognized as a critical driver of economic growth and poverty reduction in many developing countries. Further, scaling up successful development interventions by going beyond the one-off, small-project approach will help to achieve sustainable impact at a scale that substantially addresses the challenges of agricultural productivity growth, rural poverty and food insecurity, as observed by Johannes Linn, Chair of the roundtable, who also served as External Chair of the Ninth Replenishment of IFAD Resources.

The need to accelerate and scale up successful agriculture and food and nutrition security programmes is clear and deepening. It occurs against a backdrop of global economic uncertainty, changing aid architecture and a proliferation of new actors in development.

The context is also defined by the failure of donors, lenders and borrowers to invest in the agriculture sector over several decades. The result is a formidable investment gap in developing country agriculture, estimated in 2009 at US$83 billion per year.[1] This means that investment in developing country agriculture will have to grow by about 50 per cent to support the necessary expansion in output.[2]

These factors are driving IFAD to explore both new sources of investment in rural development and new mechanisms through which to channel such investments. The Fund is beginning to explore new forms and sources of financing to identify which would be compatible with IFAD's operational, financial and legal structure. In launching this effort, IFAD Management begins from the premise that these exploratory activities are driven by the need to identify alternative sources of financing that are additional to traditional Member State contributions and IFAD's own resources (loan repayments and income earned on the Fund's investment portfolio), which are the foundation of IFAD's resource mobilization.

To help launch this exploration, IFAD convened a *Roundtable on Mobilizing Resources for IFAD Programmes: Alternative Sources and Innovative Modalities* in Rome on 12-13 June 2012. The roundtable explored four topics: trust funds, sovereign investing, Islamic finance and private sector investment. This report summarizes the highlights of the roundtable. IFAD looks forward to expanding the dialogue started at the roundtable and continuing to share insights and experiences with the participants and other interested parties.

1 According to the Food and Agriculture Organization of the United Nations.

2 High-Level Expert Forum: How to Feed the World 2050 – Oct. 2009, at www.fao.org/fileadmin/templates/wsfs/docs/Issues_papers/HLEF2050_Investment.pdf.

Trust funds: Learning from experience

This session featured panelists who shared their experiences with multi-donor trust funds highlighting the pros and cons of these arrangements.

Moderator: Kevin Cleaver, Associate Vice President, IFAD
Bisrat Aklilu, Executive Coordinator, Multi-Partner Trust Fund Office, UNDP
Federica Cerulli, Partnership Officer, IFAD
Roberto Tarallo, Manager, Global Partnerships and Trust Fund Operations, World Bank

Background

Donors increasingly rely on multilateral organizations to channel bilateral resources for designated purposes. These contributions are in addition to their core contributions to the regular operations of these institutions. Trust funds are widely used by international financial institutions and development organizations as a mechanism for mobilizing and administering these non-core resources.

Examples and experiences

The World Bank holds around US$29 billion in trust, spread over more than 1,000 accounts, and disburses approximately US$8.7 billion annually. Sovereign donors provide the majority of resources for World Bank trust funds, but contributions also come from private foundations, corporations and other non-profit and for-profit entities. The trust funds finance a wide range of development activities, from regional and country-specific development projects to technical assistance to coordinated action related to global public goods.

The United Nations Development Programme (UNDP) Multi-Partner Trust Fund Office was established in 2004 to administer trust funds for operations involving multiple UN agencies. It maintains approximately US$6.8 billion in assets and disburses about US$1 billion annually. The Office provides a means of streamlining fund management within the UN system by having one entity act as administrative agent for programmes that involve multiple agencies. Funding may originate from participating UN agencies or other sources, including sovereigns, public entities, the private sector and even individual donors.

What are trust funds?

Trust funds are vehicles for channeling aid resources from governmental and nongovernmental donors to be administered by a trustee organization… Trust funds are not programs in themselves; rather, they are dedicated sources of funding for programs and activities agreed between the donor(s) and the trustee organization.

-- from "Trust Fund Support for Development," Independent Evaluation Group, World Bank, 2011

In contrast, the volume of grant and loan resources that IFAD mobilizes and administers separately from its core resources is relatively small – US$212.5 million in supplementary grants on behalf of donors and €300 million in loans on behalf of investors. IFAD received greater amounts of non-core resources between 2007 and 2009, as donor countries responded to the surge in commodity prices. As a result, IFAD is becoming more active in soliciting non-core resources and more focused on trust funds as a specific mechanism for their management.

Opportunities

Trust funds provide a mechanism for realizing a number of opportunities. They are a familiar vehicle for mobilizing large amounts of resources from a wide range of donors. They also can support innovation and extend the reach and capacity of bilateral donors while potentially increasing aid effectiveness. They do so by improving donor coordination and increasing versatility by operating in a more flexible manner.

The World Bank, for example, employs trust funds as flexible instruments to test innovative ideas that may not be funded with core resources. These might include pooling financing to target particular development issues across a range of countries, or directing aid to non-state or other entities to which the Bank could not otherwise provide resources.

Trust funds also offer the opportunity for donors to have impact in areas where they have limited options for bilateral engagement. For example, UNDP established its fund for Iraq in 2004, when many potential donors lacked the capacity to establish a field presence there.

Challenges

The effective operation of trust funds also presents a set of challenges. The first of these is how to discourage donors from substituting trust fund contributions for core contributions. One strategy for mitigating this risk of core resource erosion is to establish a ceiling on the amount a Member may contribute through trust funds, pegging the amount to its total replenishment contribution.

Another challenge is how to ensure that programmes financed by trust funds align with institutional priorities while also appealing to donors' specific funding goals. A willingness to support donor priorities is a key factor in the establishment of trust funds. However, safeguards are needed to protect against 'mission drift' or the risk of being subject to bilateral political agendas. One such safeguard is to establish multi-donor, rather than single-donor, trust funds.

Trust funds are generally unpredictable resource mobilization tools, which makes planning difficult. While it is relatively simple to establish a trust fund, ongoing replenishment is not always easy to ensure. Further complicating the picture, very few trust funds are ever closed. When trust funds that are not achieving stated objectives or being adequately replenished are kept nominally active, problems can result in terms of governance and effectiveness.

To streamline trust fund establishment and management, the World Bank, UNDP and IFAD all use standardized agreement documents to mobilize supplementary grant resources. These agreements are typically modified to varying degrees to meet the requirements of specific donors. Standardization minimizes administrative costs and reduces the risk that trust funds will operate outside of established institutional policies. Standardization also facilitates donor harmonization and helps to ensure that trust funds have clearly defined objectives.

Regular reporting to update and share performance results with donors is also facilitated by a standardized agreement. Further, transparency in funds management helps to reinforce donor confidence and commitment to harmonization.

Member States have stressed that a growing portfolio of trust funds should not lead to an alteration of the basic governance of international financial institutions, which is based on periodic replenishments and ties contributions to voting rights.

Outlook for IFAD

Growing IFAD's trust fund portfolio has many advantages, including enhancing the Fund's ability to scale up successful programmes by multiplying the sources of funding to support such initiatives. The monies administered through trust funds are often more versatile because of their specific objectives and the fact that they are not subject to IFAD's Performance Based Allocation System.[3] As a result, they strengthen the Fund's capacity for innovation in programme design and in providing innovative technical assistance and capacity-building services, which client countries may not be willing to finance through borrowing.

On the other hand, with a larger trust fund portfolio, IFAD will have to navigate the tension between its core mandate – to make concessional financing available for agricultural development in developing countries – and the tendency of donors to want to earmark trust funds. On an administrative level, this is important because of the tendency of earmarked trust funds to proliferate and become unmanageable. Assuring IFAD's effectiveness requires that its projects focus on results, whatever their source of funding. From the perspective of aid recipients, it is important to ensure that financing instruments promote sustainability rather than dependency.

A further issue is the need to reassure IFAD's governing bodies that the Fund will not incur undue financial or reputational risk from diversifying its funding sources. This will require proactive management of trust funds and a concerted effort to identify those contributors whose objectives best align with IFAD's strategic priorities; IFAD cannot be a passive recipient of donor initiatives.

To meet the challenges outlined above, IFAD may choose to focus on establishing a limited number of thematic multi-donor trust funds that are closely aligned to its strategic priorities.

The success of other institutions in establishing trust funds highlights the donor interest in these mechanisms. It also indicates that funds are available to finance them, particularly in the agriculture sector. IFAD is favourably placed to channel these resources towards smallholder agricultural and rural development. In addition to creating its own trust funds, IFAD could explore participation in those managed by other institutions, such as the Multi-Partner Trust Fund. IFAD is already doing so in the case of the Global Agriculture and Food Security Program, for which the World Bank serves as trustee.

3 This system is the formula used for allocating IFAD's loan and grant resources to country programmes on the basis of country performance (the broad policy framework, rural development policy and portfolio performance), and need (population and per capita gross national income). Resources are allocated in three-year cycles.

IFAD: An investment opportunity for public institutions

This session focused on lending to development institutions by the public sector. Panelists reviewed the design and structure of certain multi-donor trust funds, explored the pros and cons of these vehicles, and discussed the possibilities for replication.

Moderator: Hugo Beteta, Sub-Regional Director, Economic Commission for Latin America
Antonella Bassani, Director, IDA Resource Mobilization Department – via videoconference
Benoît Chervalier, Head, Resource Mobilization and Allocation Unit, AfDB
Chris Hemus, Deputy Director, Finance Department, IMF
Rutsel Martha, General Counsel, IFAD
Elizabeth Uwaifo, Partner, Sidley Austin LLP

Background

Some institutions are newly focused on borrowing resources as a means of mobilizing development finance. This approach reflects the economic and budgetary constraints that many Member States are experiencing, which are limiting resources available for grant contributions. In most cases, institutions are focusing first on the prospect of tapping loan programmes of Member States, without foreclosing the possibility of borrowing from the private sector at some future date.

Examples and experiences

In exploring the possibility of debt financing, the International Monetary Fund (IMF) and the World Bank's International Development Association (IDA) have, for now, excluded the option of seeking private sector loans or loans from public entities other than governments, even though this is legally permissible. Such borrowing requires establishing a credit rating, which is a long and costly process. At the same time, government loans may be a first step towards private sector borrowing.

The IDA is exploring ways to incorporate debt funding into its financial structures as one of the options for improving its long-term financial sustainability. A donor working group is examining the possibility of arrangements for borrowing and on-lending concessional loans from Member States. The group is in the process of assessing the financial factors that need to be addressed, such as liquidity requirements, exchange rates and credit risks, as well as possible implications for IDA governance and risk management.

The African Development Fund, the concessional window of the African Development Bank, is also looking at ways to supplement its existing financing mechanisms. The option of borrowing from Member States for on-lending is limited by the fact that 40 of the 41 Fund-eligible countries borrow only on concessional terms.

The IMF has two mechanisms for borrowing that serve to supplement the quota subscriptions of member countries when quota resources are deemed to be inadequate.[4] These mechanisms, the General Arrangements to Borrow and the New Arrangements to Borrow, are agreements through which member countries and institutions stand ready to lend additional resources, if needed. The IMF also has a limited number of bilateral borrowing agreements as an additional option for augmenting available resources. It maintains precautionary reserves to back its lending and address credit risk.

Resources from quota subscriptions and from loans under the New Arrangements to Borrow and General Arrangements to Borrow are lent to member countries with actual or potential balance-of-payments needs. The loan is meant to enable the country to honour its financing commitments while making adjustments and reforms to establish economic stability and the financial foundations for growth.

IMF concessional lending to low-income countries is carried out through its Poverty Reduction and Growth Trust Fund. The difference between the market rate at which these resources are borrowed and the highly concessional rate at which they are on-lent to low-income countries is financed by grant contributions from bilateral donors and the IMF's own resources. This form of interest rate buy-down, which entails applying grant resources to subsidize on-lending rates, is one solution for complying with a concessional finance mandate.

In 2010, IFAD established the Spanish Food Security Cofinancing Facility Trust Fund (Spanish Trust Fund). This €300 million financing facility is comprised primarily of a loan from the Spanish government, with a €14.5 million grant component. The grant element is intended to compensate for any gap between the 12-month EURIBOR interest on the loan and the interest received by the trust fund on loans to borrowing countries. Much like the interest rate buy-down feature of the IMF's concessional lending, this grant feature facilitates IFAD's on-lending to Member States at concessional rates, as required by its mandate. The financial model underlying the Spanish Trust Fund was developed to guarantee reimbursement of the loan to Spain; at least 50 per cent of the loan will be allocated under IFAD ordinary terms, which remain below market rates.

IFAD's mandate requires it to make concessional financing available to developing Member States for agricultural development. Accordingly, all of the Fund's lending terms – from concessional to ordinary – are below current market rates. This feature does not impair IFAD's legal authority to pursue debt financing to support its programmes. Additionally, the Fund has tools in place for managing cash flow and liquidity risks, and the denomination of its loans in Special Drawing Rights serves to mitigate some of the currency exchange rate risk.

Opportunities

Debt financing options could be an important means of mobilizing funds to supplement core resources based on replenishment contributions. Making such an option available to public bodies may also expand existing donor participation and attract non-traditional public investors, such as central banks and sovereign wealth funds.

4 Each member of the IMF is assigned a quota, based broadly on its relative size in the world economy, which determines its maximum contribution to the IMF's financial resources. Source: "Where the IMF Gets Its Money," IMF Factsheet, May 2012, www.imf.org/external/np/exr/facts/finfac.htm.

Challenges

The use of debt funding for development finance raises a number of challenges, mostly having to do with managing increased risk. Measures to address risk may include, for example, higher liquidity and capital adequacy requirements. Other measures may be needed to address potential timing mismatches between the need to service debt and repayment of concessional donor loans. The risk of default by borrowers must also be anticipated. Finally, higher liquidity requirements may reduce internal resources available for highly concessional lending.

One measure that would better equip international financial institutions for debt funding is revising current lending terms and conditions – shortening grace periods, reducing maturity periods or increasing interest rates – such that they are better positioned to service the cost of borrowing. These options need to be reviewed with due consideration of the finance needs and development objectives of the borrowing countries.

Another important challenge is how best to determine and acknowledge the concessional dimension of debt financing provided by Member States so that such assistance can be included in calculations of their official development assistance. While the subsidized or grant element of sovereign-generated debt financing could initially be counted towards official development assistance, it is not clear how this would be treated upon repayment of the loan. A further challenge would be determining whether this form of assistance could be counted as replenishment contributions, with possible implications for voting rights.

An additional challenge is how to avoid creating perverse incentives for donors to substitute loans for traditional grant contributions. Indeed, given IFAD's concessional finance mandate, the soft-loan windows of international financial institutions and the fact that on-lending is largely provided through highly concessional loans and grants, it is critical to maintain the bulk of Member financing in the form of grant contributions. It is also worth keeping in mind that, while borrowing would facilitate an increase in IFAD's programme of work, it would not serve to increase IFAD's assets. There is a key distinction between borrowing from public entities and receiving replenishment contributions from such entities.

Outlook for IFAD

The discussion identified the following issues that IFAD will want to explore further:

- IFAD may wish to consider how potential public lenders would differ across countries and across agencies within countries (e.g. central banks, national governments, sovereign funds) in terms of their appetite for making loans, the security and risk mitigation measures required, and the rules and regulations governing their lending. Member State support for this approach is critical, in part to avoid undermining replenishment contributions.
- IFAD may wish to explore replication of existing borrowing vehicles, such as the Spanish Trust Fund. It might also consider other types of sovereign borrowing, such as issuing notes or other forms of debt to the official sector, as the IMF has done.
- IFAD may also wish to consider how to structure sovereign borrowing transactions to effectively buy down the interest rates that it charges borrowers, thereby ensuring compliance with its concessional financing mandate.
- Finally, IFAD will need to explore (a) what incentives it can offer donors to contribute loans while avoiding substitution for regular grant contributions; (b) how to manage prudential and reputational risks involved in debt financing; and (c) whether to avoid single-donor loan funds in favour of multi-donor loan funds.

Islamic Finance

Islamic finance is an area of significant potential for resource mobilization in support of agricultural development. Experts shared their views on the innovative dimensions of Islamic finance, the lessons learned and best practices, and the potential for investors coming from this tradition to engage in financial partnership with an organization such as IFAD.

Moderator: Hafez Ghanem, Senior Fellow, Brookings Institution
Amer Bukvić, CEO, Bosna Bank International
Antje Kaspurz, Investment Management Officer, IFAD
Salman Syed Ali, OIC Islamic Economics and Finance Research, IsDB
Mohammad Saeedullah, Principal Capital Markets Specialist, Treasury, IsDB

Background

Islamic finance is a large and growing financial sector. With a market size of US$1.3 trillion, growing at about 15 per cent per year, it is garnering increasing interest from outside the Muslim world. Although Islamic financial instruments are created to conform with principles of Islamic law, for most of these instruments there is no requirement for the parties using them to have a religious affiliation with Islam.

Islamic finance is a means of administering financial assets in accordance with Islamic principles. Although many Islamic finance instruments are comparable to those of conventional finance, a key distinction is that Islamic finance is not debt-based. Instead, Islamic finance links the financial economy with the real economy through the use of real asset backing (tying financial instruments to tangible goods) and by prohibiting interest and speculation. Because interest is considered to be income from money and speculation is income from chance, neither of these types of income is directly linked to tangible assets. Islamic finance also promotes certain practices, such as partnerships (rather than lender-borrower relationships), risk-sharing and profit-sharing, and *zakat* (charitable tithing).

When resources are mobilized through Islamic finance, downstream transactions using those resources should also adhere to Islamic principles to keep both liabilities and assets in compliance with the principles and prohibitions of Islamic finance. Investment proceeds should be used to finance assets rather than, for example, to earn interest. The majority of those assets should be tangible (e.g. leasing or equity investments). Non-tangible assets include, for example, receivables from instalment sales or construction contracts. Knowledge, such as that gained through technical assistance, is an asset for which an Islamic financial instrument can be issued, but it is not tradable as a tangible asset would be.

Because it links finance and the real economy, Islamic finance is well suited to agricultural development, particularly infrastructure, procurement and trade promotion, which involve the financing of tangible assets.

Examples and experiences

The Islamic Development Bank (IsDB) uses several Islamic finance instruments to mobilize resources. Among these is the *sukuk*, a financing arrangement that is similar to asset-backed bonds. The IsDB tested the market in 2003 with a five-year, US$400 million *sukuk* issuance. It is backed by a variety of other Islamic financial instruments, such as rental and construction contracts. The majority of the initial *sukuk* investors came from IsDB Member States, but attention from outside investors has grown. Since its initial successful offering, the IsDB has issued multiple *sukuk* offerings, in the range of US$750 million and above.

Another Islamic finance instrument, used by the IsDB to mobilize resources in the short to medium term, is the rollover *murabaha*. This arrangement involves commodity purchase and resale, with the bank acting as the intermediary between a seller and the ultimate buyer. By contrast, *awqaf*, the rental income on property used for charitable purposes, is a longer-term instrument that generates regular revenue and therefore creates liquidity for investors. The IsDB also administers two Islamic trust funds. One finances technical assistance, and the other is a new revolving fund to finance concessional projects.

Bosna Bank International (BBI) is a commercial bank founded by the Islamic Development Bank and the Dubai and Abu Dhabi Islamic Development Banks. BBI is dedicated to the reconstruction and socio-economic development of Bosnia and Herzegovina. It offers a range of bank services, relying exclusively on Islamic finance instruments. Most of BBI's work is in Islamic partnerships and leasing. Because Bosnia and Herzegovina does not have a legal framework for Islamic banking, BBI structured its financial instruments to fit within the commercial banking system while retaining their Islamic character. BBI has a proven record of success using Islamic finance for agricultural development, including very low default rates on agricultural lending. Consequently, the Turkish Government has given BBI a 10-year line of credit of up to €100 million at zero interest and pays the bank to manage those resources. Its ability to demonstrate development results was key to increasing BBI's resource mobilization capacity.

Opportunities

Islamic finance represents an important source of development finance because of the scale of resources that may be available and the chance it offers to explore new partnerships and deepen existing collaboration with countries and public institutions in the Arab and Gulf region. These countries are demonstrating strong interest in investing in agricultural development. The existing financial and operational structures and mandates of many development institutions are largely compatible with Islamic finance principles and requirements.

Challenges

Potential partnership using Islamic finance principles and instruments depends on a thorough understanding of such principles and modalities. Collaboration with institutions whose experience in the sector best complements that of IFAD or other development institutions may offer the best opportunity for gaining greater familiarity with this approach.

The possibilities for partnering with Islamic financial institutions may be limited by the need to ensure that any resources mobilized through Islamic finance are linked to appropriate on-lending projects. For example, such projects should not include lending on intermediate or ordinary terms, which include interest charges.

Ensuring that the asset mix of a project is both compliant with Islamic finance principles and fully supportive of the development goals of the project may prove challenging. While Islamic finance should mainly be used to finance tangible assets, such as buildings and machinery, some projects may also include components that finance intangible assets like technical assistance or that aim to improve rural access to conventional financial services like debt financing and insurance.

Outlook for IFAD

IFAD has much to learn about Islamic finance, but the preliminary outlook for mobilizing resources is quite promising. It may attract financing from Member States who have available resources and interest in development investment. At a minimum, IFAD's openness to exploring Islamic finance options would show a good faith effort to begin a dialogue with those states.

An Islamic finance trust fund may be the easiest way for IFAD to make an initial foray into Islamic finance. As with the Spanish Trust Fund, the resources in the Islamic trust fund could be ring-fenced from IFAD's general resources to ensure that they are managed based on principles acceptable to Islamic finance. Another option for IFAD would be to partner with an Islamic financier. The financier could provide capital while IFAD could provide management and expertise for projects conforming to both Islamic principles and IFAD's guidelines and objectives.

There are several other Islamic financial instruments that may offer partnership opportunities for IFAD. One is *mudarabah*, through which IFAD would invest a Member State's money in a project, sharing returns with that Member State based on a predetermined ratio. Another option might be to distribute *zakat*, charitable funds raised for the poor. Because IFAD works with rural poor people, the Fund could request that a Member State allow it to access *zakat* funds to use as grant funding. Issuing *sukuk* is an option IFAD may want to revisit later, but it would likely not be the best first option because it raises some fundamental questions about IFAD's ability to issue any type of bond.

For any venture into Islamic finance, a pilot project may be a good way to test the appetite for investment and grow IFAD's in-house expertise for using the instruments. Best practices from the pilot could be scaled up into a more lasting resource mobilization tool.

Exploring opportunities for working with private investors

A variety of instruments are available for attracting development financing from private sources. The discussion reviewed best practice strategies and instruments, drawing on experience in banking, impact investing and innovative financing in other sectors, such as health and climate change.

Moderator: Iain Kellet, Chief Financial Officer, IFAD
Deborah Burand, Professor, University of Michigan Law School
Craig Courtney, Senior Independent Consultant
Laura Mecagni, Head, Global Agriculture and Food Security Program, Manufacturing, Agribusiness and Services Department, IFC
Siddharth Tata, Agriculture Portfolio Manager, Acumen Fund India

Background

Private sector investment resources for development are vast. Around US$212 trillion in assets under management are reportedly seeking environmental and social returns, while around 20 per cent of assets under management are invested in the agriculture sector. This suggests a great appetite by investors in the sector. To tap these resources, a wide range of development agencies are increasingly turning towards traditional financial instruments to engage with the private sector and private investors. Experience to date suggests significant potential, but also substantial challenges, in this approach.

Examples and experiences

The International Finance Corporation (IFC) is the arm of the World Bank Group that focuses on private sector development. It relies primarily on syndicated and parallel lending for channelling capital towards private ventures in developing countries while mitigating country, credit and reputational risks for commercial investors.

Under its Syndicated Lending Program, IFC typically serves as the lead agent or underwriter of loans financed by a group of lenders (the syndicate), largely comprised of commercial banks. The private sector borrower enters into a single loan agreement with IFC, which acts as the lender of record. This approach allows the members of the syndicate to benefit from IFC's preferred creditor status and associated privileges and immunities. In addition, the syndicate has access to IFC's due diligence and project analysis skills, and benefits from its expertise and global presence. IFC's syndicated lending programme has mobilized over US$39 billion in financing for over 1,000 projects, with an average loan size of US$119 million, making it the largest programme among the multilateral development banks.

In parallel lending arrangements, which include development finance institutions and sovereign governments as co-lenders, IFC serves as one of the participants in the syndicate. In this structure, IFC is not the lender of record; therefore, the other syndicate participants are not entitled to the preferred creditor status.

Similar to the parallel loans used by the IFC, the US Overseas Private Investment Corporation also enters into framework agreements with large commercial banks. However, unlike the IFC, the banks originate these loans, rather than the Corporation.

Alliance for a Green Revolution in Africa is identifying risk-sharing instruments for working with commercial banks. Public sector entities are funding risk-sharing facilities that are leveraging much greater private sector resources. In Kenya, for example, the Government has invested US$65 million to leverage US$500 million for smallholders. The seed money used to launch the first experiment was made available to Equity Bank of Kenya through an IFAD-financed project.

The Acumen Fund is a non-profit, global venture capital firm that invests in companies providing critical goods and services at affordable prices to low-income families. In India, the Fund has found that private investors have a strong interest in investing in agriculture. The Acumen Fund is investing in the early stages of enterprise development, which is especially risky and often relies on philanthropic funding. One example is investment in drip irrigation in India. A local company received a grant from the Gates Foundation to create a market for the product, and one of its promotion strategies involved a Bollywood film. Other competitors involved in drip irrigation also benefited from this promotion.

Opportunities

Agricultural finance is becoming increasingly attractive to investors looking for opportunities to fund programmes and projects that yield both social benefits and financial returns. A wide range of investors are interested in agriculture. These investors range from philanthropic foundations, at one end of the spectrum, to private equity investors and commercial banks at the other. Many of the projects currently financed by development institutions represent the kind of products that investors are seeking. The key is to develop sustainable investment models and bankable investments.

Challenges

Engaging with private sector investors such as commercial banks, foundations, sovereign wealth funds and high-net-worth individuals raises a number of issues. The many institutional differences, including approaches and mandates, raise a series of complicated questions related to the feasibility and viability of partnerships. It is thus especially important to choose appropriate partners and anticipate difficult issues. These include, for example, the question of harmonizing expectations of return on capital and determining how to structure risk and revenue sharing and assignment rights. It is also important to think about exit strategies in cases where investments fail to meet projected financial targets.

Additional challenges relate to achieving alignment of the financial and social objectives of the loaned funds across participating institutions; a similar alignment challenge exists with respect to social and environmental due diligence standards and methodologies applied across institutions. It can also prove difficult to harmonize operational requirements across participating institutions, particularly with respect to agreeing to a common interest rate and disbursement mechanisms.

Given the variety of types of investment finance available, an additional challenge is to identify the optimal timing of a private sector partnership. The partners may come together at the beginning of a project, as co-financiers, or at a later point, as buyers of assets developed through projects financed by development institutions.

Finally, development institutions need to consider reputational risks that may arise from partnering with some actors in the private sector. Questions may be raised about partnerships built on public resources that result in private profits. Careful thought needs to be given to criteria that will help avoid or mitigate such risk.

Outlook for IFAD

Given its demonstrated expertise in the agriculture sector, IFAD is in a position to explore its potential to access this rapidly growing source of funding and develop new and fruitful partnerships with private investors.

While IFAD's current business model may limit its ability to collaborate with purely commercial investors, it is easy to imagine how the Fund could partner with philanthropic organizations having low expectations of financial returns, as well as with impact investors who seek both financial and social/environmental returns on their investments. Such a partnership could be in the form of cofinancing, parallel financing or contributions to trust funds administered by IFAD or other organizations. It could also be in the form of technical assistance provided by IFAD or the partner organization. For both philanthropic organizations and impact investors, these partnerships could serve to channel more resources towards agricultural development and maximize the development impact of projects supported by IFAD.

IFAD will need to evaluate whether the rates of return on its concessional financing are sufficiently high to partner with purely commercial investors, whether it would be financially and constitutionally feasible to advance such partnerships, and on what terms. Similarly, it will want to tailor proposals for financial and technical partnership with those whose financial and social return expectations are most in line with its own, such as impact investors. In addition, IFAD will need to consider systematically the reputational risks inherent in partnering with private actors. For example, where cofinancing is involved at the outset, IFAD should develop project design and reporting mechanisms for ensuring that its partners abide by the same environmental and social standards as those currently applied to IFAD-supported projects.

Finally, it was noted that if IFAD is to successfully engage with private investors, it would need to clearly express its expectations with respect to the desired impact and outcomes of its programmes, and also agree to the mechanisms that will be relied upon to demonstrate and record such impact. In other words, it will be important to identify and agree to the appropriate impact evaluation metrics at the outset. To the extent that investor interest in impact evaluation is growing, and given that IFAD projects have regularly scored highly on independent impact evaluations, the emphasis on measurable impacts should not create roadblocks to partnership.

Conclusions

The discussions highlighted that significant resources are available globally to support agricultural and rural development in poor countries. These funds are being deployed by actors as diverse as sovereigns, development organizations, commercial banks, microfinance institutions and impact investors. All of them are increasingly focused on agriculture, both as a growth sector and as a vehicle for fostering economic and social development.

The roundtable provided an important opportunity to begin to explore some of the mechanisms that IFAD could pursue to increase the volume and poverty-reducing impact of resources being channeled towards agricultural development. All four of the topics discussed in the roundtable bear further exploration. Each requires a different set of institutional measures, frameworks, expertise and partnerships to be put into effect. Some may imply a retooling of how IFAD operates.

For certain mechanisms, particularly trust funds financed by donors and lenders, action can be taken swiftly to expand and improve current approaches. For others, such as issuing various forms of debt to the public sector, additional institutional capacity-building is needed, along with a deeper understanding of the feasibility and potential supply and demand for less concessional borrowing. As such, this area could be explored in the near to medium term.

As concerns Islamic finance, it will be necessary to collaborate closely with experts to assess thoroughly the compatibility of this form of financing with IFAD's operational, financial and legal structure. Exploration of this issue will require some time. However, the establishment of an Islamic finance trust fund could be pursued on a shorter timeline.

Finally, given the institutional differences between private sector entities and public organizations, particularly with regard to expectations of return and financial risk mitigation, exploring debt transactions with private lenders will take place on a longer term basis. However, IFAD can begin pursuing prospects for cofinancing agricultural development projects, particularly with private investors who, like IFAD, attach value to development impact.

The roundtable marked the launch of a multi-year effort to examine new avenues for supporting IFAD's work in fighting rural poverty. It was important for identifying shorter and longer term possibilities that IFAD will explore in a systematic fashion to attract new sources and forms of funding for its programmes. To succeed, IFAD will need to work closely with its Member States and others involved in developing new approaches to financing for agriculture. The roundtable helped IFAD to identify key institutions and individuals in this area with whom it hopes to remain engaged as it moves forward.

Annex
List of external participants

Institution Type	Institution	Participant	Title
IFIs/MDBs/MDFIs	AfDB	Benoît Chervalier	Head, Resource Mobilization and Allocation Unit (ORMU)
IFIs/MDBs/MDFIs	AfDB	Preeti Sinha	Principal Resource Mobilization Officer, Resource Mobilization and Allocation Unit (ORMU)
IFIs/MDBs/MDFIs	AfDB	Ngarnim-Ganga	Manager, Legal Services Department
IFIs/MDBs/MDFIs	FMO	Anton Timpers	Senior Investment Officer, Agribusiness Department
IFIs/MDBs/MDFIs	IFC	Marta Gucciardini	Co-ordinator for Italy
IFIs/MDBs/MDFIs	IFC	Laura Mecagni	Head, Global Agriculture and Food Security Program, Manufacturing, Agribusiness and Services Department, IFC
IFIs/MDBs/MDFIs	IMF	Chris Hemus	Deputy Director, Finance Department
IFIs/MDBs/MDFIs	Islamic Development Bank	Mohammad Saeedullah	Principal Capital Markets Specialist, Treasury Department
IFIs/MDBs/MDFIst	Islamic Development Bank	Salman Syed Ali	Officer-in-Charge, Islamic Economics and Finance Research Division
IFIs/MDBs/MDFIst	Islamic Development Bank	Seedy Keita	Head of Finance, Islamic Cooperation
IFIs/MDBs/MDFIs	World Bank	Antonella Bassani	Director, IDA Resource Mobilization Department
IFIs/MDBs/MDFIs	World Bank	Roberto Tarallo	Manager, Global Partnerships and Trust Fund Operations
Bilateral Development Agencies	Economic Commission for Latin America (ECLAC)	Hugo Beteta	Sub-Regional Director (former Minister of Public Finance for Guatemala)

Institution Type	Institution	Participant	Title
Bilateral Development Agencies	USAID	Franklin Moore	Senior Development Counsellor
UN Agencies	FAO	Richard China	Director of the Policy Programme and Development Support
UN Agencies	FAO	Purveen Kharas	Senior Programme Officer
UN Agencies	FAO	Craig Fedchock	Coordinator of the IPPC and former US trade negotiator with a substantial knowledge in PPPs and innovative financing
UN Agencies	FAO	Téa Franich	Advocacy Officer
UN Agencies	UN Capital Development Fund	Magnus Magnusson	Chief, Partnerships Unit
UN Agencies	UNDP	Bisrat Aklilu	Executive Coordinator, Multi-Partner Trust Fund Office, Bureau of Management
UN Agencies	WFP	Marco Selva	Head Private Partnerships
Official Bodies	Angola	Carlos Amaral	Permanent Representatives
Official Bodies	Banca d'Italia	Giovanni Majnoni	Senior Director, Risk Management
Official Bodies	Belgium	Martine Van Dooren	Permanent Representative to the UN Agencies
Official Bodies	Canada	Adair Heuchan	Deputy Permanent Representative
Official Bodies	China	Li Xinhai, Counsellor	Deputy Permanent Representative of the People's Republic of China to the UN Food and Agriculture Agencies
Official Bodies	China	Shen Zhihua	Third Secretary, Alternate Permanent Representative of the People's Republic of China to the UN Food and Agriculture Agencies
Official Bodies	China Africa Development Fund	Liu Jianguo	Executive Director of Agriculture and Real Estate Investments

Institution Type	Institution	Participant	Title
Official Bodies	European Union	Lourdes Magana	Advisor, European Union Delegation to the Holy See, the Order of Malta and the United Nations Organisations in Rome
Official Bodies	France	Elizabeth Connes-Roux	Deputy Permanent Representative
Official Bodies	France	Cécile Humbert-Bouvier	Economic Adviser, IFAD Executive Board Representative
Official Bodies	Germany	Michael Bauer	First Counsellor, Permanent Representation of Germany
Official Bodies	Mexico	Alan Romero	Alternate Permanent Representative
Official Bodies	Ministry of Economy & Finance of the Italian Republic	Stefania Bazzoni	Director, Directorate General for International Financial Relations
Official Bodies	Ministry of Economy & Finance of the Italian Republic	Lucia Senofonte	Directorate General for International Financial Relations
Official Bodies	Ministry of Foreign Affairs of the Italian Republic	Nicola Pisani	Expert, Office of Relations with non-financial International Organizations (Office II)
Official Bodies	Ministry of Foreign Affairs, Switzerland	Cristine Grieder	Permanent Representation of Switzerland to FAO, IFAD and WFP
Official Bodies	Sweden	Amalia Garcia-Tharn	Permanent Representative of Sweden to IFAD
Commercial Banks	Bosna Bank International	Amer Bukvić	CEO
Commercial Banks	Morgan Stanley	Kaylan A. Christofferson	Debt Capital Markets
Commercial Banks	Standard Chartered Bank	Steven Marshall	Director, Transaction Banking
Commercial Banks	Standard Chartered Bank	Inci Yalman	Regional Head of Development Organisations

Institution Type	Institution	Participant	Title
Commercial Banks	Wells Fargo	Lucy A. Kinosian	Senior Vice President, Portfolio Strategies and Credit Origination
Impact Investors and Commercial Investors	Acumen Fund	Siddharth Tata	Agriculture Portfolio Manager, India
Impact Investors and Commercial Investors	Blue Orchard	Geert Roosen	CFO
Academia and Think Tanks	Alliance for a Green Revolution in Africa	Nixon Bugo	Program Officer Innovative Finance
Academia and Think Tanks	The Brookings Institution	Hafez Ghanem	Senior Fellow
Academia and Think Tanks	The Brookings Institution	Johannes Linn	Senior Fellow
Academia and Think Tanks	University of Michigan Law School	Deborah Burand	Professor of Impact Lawyering at University of Michigan Law School, and previously GC at Overseas Private Investment Corporation (OPIC)
Academia and Think Tanks		Craig Courtney	Senior Independent Consultant
Law Firms	Luther	Oltmann G. Siemens	Counsel, Munich Office
Law Firms	Sidley Austin LLP	Elizabeth Uwaifo	Partner in London specializing in Global Finance and Investment Funds, Advisers and Derivatives
Law Firms	Sidley Austin LLP	Zartasia Khan	Associate
Law Firms	Sidley Austin LLP	Jung-ui Sul	Associate

The International Fund for Agricultural Development (IFAD), a specialized agency of the United Nations, was established in 1977 with the mandate to mobilize resources for agricultural development in developing countries. Since its inception, IFAD has invested almost US$14 billion in concessional loans and grants for some 900 projects in 120 countries and territories. In addition, IFAD has mobilized about US$21 billion in cofinancing from domestic contributions and bilateral and multilateral sources. Its work has empowered about 400 million poor rural people to grow more food, better manage their land and natural resources, learn new skills, start small businesses, build strong organizations, and gain a voice in the decisions that affect their lives.

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