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IFAD
Investing in rural people

President's report

Proposed loan to the People's Republic of Bangladesh for the Promoting Agricultural Commercialization and Enterprises Project

Note to Executive Board representatives

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Executive Board — 112th Session
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For: **Approval**

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Abbreviations and acronyms

COSOP	country strategic opportunities paper
FEDEC	Finance for Enterprise Development and Employment Creation
M&E	monitoring and evaluation
PACE	Promoting Agricultural Commercialization and Enterprises
PKSF	Palli Karma-Sahayak Foundation (Bangladesh)
PMU	project management unit (of PACE)
POs	partner organizations (of PKSF)

Map of the project area

People's Republic of Bangladesh

Promoting Agricultural Commercialization and Enterprises Project

Financing summary

Initiating institution:	IFAD
Borrower:	Ministry of Finance
Executing agency:	Palli Karma-Sahayak Foundation (PKSF)
Total project cost:	US$92.85 million
Amount of IFAD loan:	SDR 26.35 million (equivalent to approximately US$40 million)
Terms of IFAD loan:	Highly concessional
Cofinancier(s):	PKSF and partner organizations (approximately 200) Government of the Republic of Korea
Amount of cofinancing:	PKSF: US$22.45 million PKSF partner organizations (microfinance institutions): US$30.04 million Republic of Korea supplementary funds: US$0.36 million
Appraising institution:	IFAD
Cooperating institution:	Directly supervised by IFAD

Recommendation for approval

The Executive Board is invited to approve the recommendation for the proposed financing to the People's Republic of Bangladesh for the Promoting Agricultural Commercialization and Enterprises Project, as contained in paragraph 47.

Proposed loan to the People's Republic of Bangladesh for the Promoting Agricultural Commercialization and Enterprises Project

I. Strategic context and rationale

A. Country and rural development and poverty context

1. Bangladesh is one of the most densely populated countries in the world. About 80 per cent of the population live in rural areas; more than two thirds are landless or functionally landless (owning less than 0.2 hectares of land); 31.5 per cent live below the national upper poverty line; and 17.6 per cent are classified as very poor. Although poverty has been declining, it remains pervasive, particularly in rural areas, as a result of limited access to land and other natural resources, new technologies and markets.

2. Over the past decade, agricultural production has become increasingly commercialized. Even poor producers with minimal production capacities now produce to sell. This transformation is driving the rapid adoption of technologies for improving productivity and profitability. Critical services for farmers and other microentrepreneurs include extension, opportunities to upgrade production technologies and access to finance. At the same time, it is important to understand that agricultural development alone will not generate sufficient income to meet the needs of an expanding population and reduce rural poverty. An increasing proportion of rural income will need to come from the non-farm sector.

3. The Promoting Agricultural Commercialization and Enterprises Project (PACE) is designed to support smallholders in fully capitalizing on opportunities for commercialization in agriculture and the growing rural non-farm sector. It builds on the experiences of previous development projects, and scales up successful interventions – especially the IFAD-supported Finance for Enterprise Development and Employment Creation Project (FEDEC). The lessons of the 42 small value chain development subprojects implemented under FEDEC increased the incomes of microentrepreneurs and other participants through increased sales and productivity, guided the design of PACE. By scaling up this approach all over Bangladesh, PACE is expected to significantly contribute to poverty alleviation and rural development.

4. The project will be implemented by the Palli Karma-Sahayak Foundation (PKSF), a leading apex institution with a large network of microfinance partner organizations all over the country. PKSF has gained significant experience in microfinance for poor people, technical assistance, microenterprise development, and capacity-building of partner organizations (POs). The foundation has already implemented three IFAD-funded finance and value chain projects. Each successive project further broadened the scope, expanded the target population and utilized an increasingly followed a more commercial and sustainable approach of expanding access to technology, market and business services. Activities successfully piloted under these projects were later scaled up by PKSF and its partner organizations.

B. Rationale and alignment with government priorities and RB-COSOP

5. PACE will directly support the sixth Five-Year Plan of the Government of Bangladesh, which places special emphasis on rural finance, support for agriculture and small farmers, micro and small enterprises, rural infrastructure, women's development and education as important means for poverty reduction.

6. The project is fully aligned with IFAD's results-based country strategic opportunities programme (RB-COSOP) and will especially contribute to achieving strategic objectives 2 (small producers and entrepreneurs benefit from improved value chains and greater market access) and 3 (marginalized groups, including poor rural women, are economically and socially empowered).

II. Project description

A. Project area and target group

7. The project will be implemented nationally since PKSF's POs operate throughout Bangladesh. While microenterprise activities will cover the entire country, value chain development activities will be driven by business opportunities related to commodities produced in different areas.

8. In line with IFAD's policy on targeting, the target group will be a wide variety of actors classified by poverty group, professional identity, gender and project component. Poverty categories will include: microentrepreneurs (borrowers from the microenterprise loan programme), moderately poor and extremely poor people. Professional identities will include marginal and small farmers involved in field crop production, horticulture, fisheries, livestock production, non-farm production and service sectors. Both women and men will directly benefit from the project, but the majority of direct beneficiaries will be women. PACE will also seek to maximize access to loans and participation in non-financial services for disadvantaged groups, including women and ethnic minorities.

B. Project development objective

9. The project goal is to enhance the livelihoods (including higher income from self-employment, business profit and wage employment, and food security) of the moderate and extremely poor people in a sustainable manner. This will be achieved by meeting means of the development objective of: increasing sales and incomes of new and existing microenterprises; and creating new wage employment opportunities for extremely and moderately poor people.

C. Components/outcomes

10. PACE has three complementary components: (i) financial services for microenterprises; (ii) value chain development; and (iii) technology and product adaptation. Project management will be an additional activity that comprises implementation and coordination of all project activities.

11. **Component 1: Financial services for microenterprises.** This component will expand sustainable financial services for microenterprise (including the farm, off-farm, trading and service sectors). The activities and targets under this component are:

- Provide microenterprise loans to 102,000 new borrowers. PKSF and POs will mobilize an additional US$50 million to finance this subcomponent. The complete IFAD loan amount is expected to be drawn down within the first three years and PKSF and partner organizations will continue financing these new 102,000 borrowers during the remaining project period and beyond. This process will ensure an exit for IFAD and the continued sustainability of financial services.

- Pilot new loan products to meet microenterprises' emerging needs. A study has identified the potential for lease finance, cluster and value-chain finance, and start-up capital. These products will be piloted by several experienced POs. If successful, they will be scaled up into the regular PKSF loan programme.
- Train an estimated 375 PKSF and partner organization officials in the management of large-scale microenterprise loan programme, monitoring and evaluation of microenterprise programme, impact assessment and utilisation of information technologies for managing and monitoring microenterprise loan programme. The training courses may be organized by PKSF or outsourced to qualified training providers.

12. **Component 2: Value chain development.** This component aims to sustainably include microenterprises into value chains in the agriculture, off-farm and service sectors in order to scale up businesses and production technologies, and enhance access to markets. Key targets and activities are:

- Develop value chains in 15 agricultural subsectors such as pond fisheries, poultry, livestock, safe vegetables, horticulture and medicinal fruits and herbs. Because of product similarity, it is expected that each agricultural subsector will include a large number of beneficiaries (overall, it is estimated that 250,000 beneficiaries will be reached). Fast progress in this activity is expected since considerable experience has been gained through FEDEC.
- Develop value chains in 15 off-farm subsectors such as shoes, leather goods, furniture and wood processing, decorative products and private vocational training. As a result of product differentiation in off-farm subsectors, subprojects will be smaller than in those in agriculture subsectors and are expected to reach 50,000 beneficiaries.
- Build the capacity of PKSF and partner organizations in designing and managing large-scale value chain development projects. The focus of capacity-building will be on designing value chain subprojects, managing value chain development activities, monitoring and evaluation, and impact assessment.
- Build the capacity of PKSF and partner organizations in policy analysis and advocacy linked to value chain development activities. To achieve this, PACE will identify, analyse and document important sector-specific policy issues such as the availability of vaccination and food-safety regulations.
- Develop a web-based platform for marketing products produced by microenterprises (with the grant supported by Republic of Korea supplementary funds).

13. **Component 3: Technology and product adaptation.** In this component, PACE will introduce proven technologies and (agricultural and off-farm) products to microentrepreneurs in order to address the production challenges identified in component 2. The project will not finance any research. Key activities and targets are:

- Address at least six technological problems such as diseases, lack of inputs and failure of disease control.
- Transfer 15 proven technologies and products to small producers and train at least 50,000 microentrepreneurs on these new technologies and products.
- Conduct 26 subsector and technical feasibility studies, and five sector-specific impact studies, and organize associated consulting services.

III. Project implementation

A. Approach

14. PACE will adopt a comprehensive approach to combining microenterprise finance and non-financial services by using the value chain development methodology. Sustainable services will be developed by strengthening local commercial service providers, such as private vaccinators. In addition, PACE will offer targeted technical assistance to overcome challenges by engaging specialized agencies and individual experts. New and well-tested technologies will be disseminated as a part of value chain development activities. Sector-specific policy constraints will be identified and addressed with the appropriate authorities to ensure pro-poor policies.

B. Organizational framework

15. The Government of Bangladesh will be the borrower of the IFAD loan. PKSF will be the lead project agency, as in the FEDEC project and two other previous IFAD-funded projects. The funds will be disbursed to PKSF in the form of a loan for the microenterprise loan component and in the form of grants for value chain development, technology transfer and product adaptation, and project management.

16. PKSF will be the main implementing agency for PACE. The microenterprise loan programme and value chain development component will be implemented through partner organizations. PKSF will procure technical assistance from reputable organizations for activities under component 3.

17. A project management unit (PMU) will be established to implement the project. The PMU will work through PKSF's Loan Operations Division to implement the microenterprise loan programme through the partner organizations. The PMU will take the lead in organizing, implementing, supervising and monitoring all activities in components 2 and 3. The PMU will also support the partner organizations in developing value chain development proposals, negotiate proposals with , obtain approval for proposals by PKSF's Value Chain Project Approval Committee, and monitor all activities.

C. Planning, monitoring and evaluation, and learning and knowledge management

18. **Planning.** The PMU will be responsible for preparing the annual workplan and budget for PACE, and obtaining approval from the Ministry of Finance and clearance by IFAD. The plan will include activities along with targets and expenditures, and will reflect the overall targets and planned activities of the project. Any revisions will be discussed and agreed upon with IFAD.

19. **Monitoring and evaluation.** PACE will have a comprehensive monitoring and evaluation (M&E) system, which will: (i) generate information that supports project management and allows adjustments to activities if necessary; (ii) generate knowledge about successful mechanisms for scaling up; (iii) generate information to monitor and evaluate the impact of project activities against project goal and objectives based on the logical framework; and (iv) generate information and knowledge for effective outreach and advocacy.

20. The M&E system will be designed around the project's logical framework. PKSF has a well-established monitoring system for financial programmes and has developed a preliminary M&E system for value chain projects. The evaluation of the value chain development component will be further strengthened by finalizing indicators for each value chain subproject. Tailored M&E systems will be incorporated into each value chain development subproject to allow for comparison against indicators and measure progress. The partner organizations have the primary responsibility for M&E in their respective subproject. All information gathered from microenterprise

loan programme, value chain development programme and technology transfer activities will feed into the overall M&E system, which will be managed by a designated M&E officer within the PMU.

21. **Learning and knowledge management.** A knowledge management system will be established to: (i) support the effective flow of information among project participants and other partners for enhanced project management; and (ii) compile lessons learned and evidence for scaling up and policy dialogue. These activities will be closely linked with the M&E system and will target all stakeholders, including beneficiaries, to ensure comprehensive learning; the utilization of information and communication technology (ICT) will be explored. Knowledge management activities will be coordinated by the PMU's M&E officer and will be included in the annual workplan and budget.

D. Financial management, procurement and governance

22. **Financial management** will be in line with previous IFAD-supported projects implemented by PKSF. PKSF has an established accounting and financial management system managed by a team of finance professionals. It follows a double-entry accounting system and all international accounting standards as adopted in Bangladesh. It routinely produces financial reports for PKSF's overall operations and its projects. The accounting software will be upgraded to automate the submission of withdrawal applications and statements of expenditure. The fiduciary risk was rated as low with the understanding that the project will recruit two dedicated accounting officers with appropriate qualifications and experience.

23. **Flow of funds.** Both IFAD and counterpart funds will be managed by PKSF. The project will have two designated accounts in United States dollars with the Central Bank of Bangladesh for the IFAD loan and the Republic of Korea supplementary funds grant. The designated account for the loan will be administered following imprest fund arrangements while the designated account for the grant will be funded through the revolving fund method.

24. **Procurement.** All procurement for the project will be in line with IFAD's Procurement Guidelines and the IFAD Procurement Handbook. Procurement by PKSF will be undertaken by its administration department; PKSF will assist partner organizations in developing and upgrading their procurement policies and processes. Procurement by the POs will also be in accordance with IFAD's guidelines.

25. **Audit.** PKSF has an internal audit team that independently audits the microfinance programmes of partner organizations as well as its own programmes. PKSF has instituted an appropriate system of internal delegation and controls. All project expenditures are reviewed by committees and an internal audit team. The internal auditors will submit a copy of reports pertaining to the use of IFAD funds to IFAD on an annual basis. In addition, the project's annual financing reports will be subject to annual audits by acceptable independent external auditors following the IFAD Audit Guidelines. The PMU will also submit unaudited financial statements on a quarterly basis.

26. **Governance**. PKSF is an independent organization with a three-tier governance system: a general body (comprising 15 members); a seven-member governing body presided over by a chairman; and the management, which is led by the managing director. The chairman in appointed by the Government, and the Managing Director is recruited by the governing body through a competitive process.

27. Over the years, PKSF has developed its management system that includes programme management, a financial system, human resources and other systems found in well-managed institutions. This system is also applied to partner organizations. The management system's transparency has been reviewed not only

by IFAD over a 10-year period, but by other organizations such as the Asian Development Bank, the World Bank and several bilateral donor agencies. PKSF's reputation for transparent and successful operations is one of the main reasons why it successfully attracts external resources.

28. The risk of corruption in PACE has been rated as low. The project will follow the governance framework developed by IFAD in Bangladesh with the objective of ensuring: (i) transparency with regard to information in the public domain; (ii) accountability in the use of resources; and (iii) beneficiary participation in project design and delivery. Important aspects of good governance have been considered within the project design, such as: (i) inclusive targeting of microentrepreneurs, small and marginal farmers, women and disadvantaged households; (ii) transparent selection of partner organizations for microfinance and value chain development activities by PKSF; (iii) participation of beneficiaries, potential beneficiaries and other stakeholders in the design and management of value chain development activities; (iv) PKSF's accounting and financial management systems, procurement system, and recruitment system; (v) audits of project accounts by PKSF's internal and external auditors; (vi) IFAD supervision and support, including spot checks by regular supervision missions, implementation support for financial management and procurement, and technical audits as needed; (vii) regular outcome surveys to provide information on how well project outputs are being delivered; and (viii) reporting of results to the Government and other stakeholders as part of knowledge management.

E. Supervision

29. The project will be directly supervised by IFAD. During the project's start-up phase, IFAD will attend the national start-up workshop and participate in discussions on the project's approach and strategy. IFAD will also conduct regular supervision and implementation support missions for PACE, and will support the PMU whenever necessary. These missions will review progress with regard to physical targets, compliance with fiduciary responsibilities and follow-up on audit recommendations.

IV. Project costs, financing, benefits

A. Project costs

30. The total project cost, including physical and price contingencies, will be US$92.85 million. The assumptions that underpin these costs are: (i) a base rate of inflation of 7 per cent for the project period; (ii) international foreign inflation at an annual average of 0.5 per cent for the project period; (iii) a base exchange rate of Bangladesh taka (BDT) 80 to US$1; and (iv) constant purchasing power exchange rates over the project implementation period. Price contingencies using the inflation parameters have been applied to most goods and services that would be procured under the project. A physical contingency rate of 3 per cent has been assumed for a limited portion of project costs since they have been estimated with reasonable certainty.

Table 1
Project costs by component and financier
(Thousands of United States dollars)

	IFAD loan	*PKSF*	*PKSF taxes*	*POs*	*Republic of Korea supplementary funds*	*Total*
Component	*Amount*	*Amount*	*Amount*	*Amount*	*Amount*	*Amount*
1. Financial services for microenterprises	20 528	20 025	2	30 038	-	70 592
2. Value chain development	14 625	-	5	-	360	14 990
3. Technology and product adaptation	852	-	27	-	-	879
4. Project management	3997	2 241	148	-	-	6 386
Total	**40 002**	**22 266**	**182**	**30 038**	**360**	**92 847**

B. Project financing

31. Of the total cost of US$92.85 million, US$40 million will be financed by IFAD through a loan on highly concessional terms. PKSF and partner organizations will contribute, in equivalent BDT value, US$20 million and US$30 million respectively to finance the microenterprise loan programme. PKSF will also contribute to the costs of project management by: covering the salaries of loan operations division staff who will manage microenterprise and other loan activities; and paying VAT and other taxes on behalf of the Government. The supplementary fund grant of US$360,000 will finance the development of an online platform for microentrepreneurs.

Table 2
Project costs by expenditure category and financier
(Thousands of United States dollars)

	IFAD loan		*PKSF*		*PKSF taxes*		*Partner organization*		*Republic of Korea supplementary funds*		*Total*
Expenditure category	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*	*%*	*Amount*
A. Equipment, furniture, goods	204	61.6	-	-	127	38.4	-	-	-	-	330
B. Training, studies, technical assistance, contracted services	15 819	97.3	-	-	55	0.3	-	-	360	2.3	16 234
C. Credit fund	20 400	29.0	20 025	28.4	-	-	30 038	42.6	-	-	70 463
D. Salaries	2 772	59.2	1 907	40.8	-	-	-	-	-	-	4 679
E. Operation and maintenance	807	70.8	334	29.2	-	-	-	-	-	-	1 141
Total	**40 002**	**43.1**	**22 266**	**24**	**182**	**0.2**	**30 038**	**32.3**	**360**	**0.4**	**92 847**

C. Summary benefit and economic analysis

32. **Benefits and beneficiaries.** The main benefits of the project will be: (i) an increase in sales as a result of the expansion of business; (ii) an enhancement in productivity resulting from the adoption of technologies and management practices; (iii) increased incomes of microentrepreneurs and other value chain actors; (iv) increased skill levels of workers and sustainable services; and (v) a conducive, sector-specific policy environment. Through its three components, the project will directly reach 452,000 households across the country. Indirect benefits are expected from the generation and dissemination of knowledge,

production technologies and management practices, and the creation of employment opportunities.

33. **Economic analysis.** The economic internal rate of return (EIRR) is estimated at 38.3 per cent over 20 years, with a net present value of BDT 247,200 million. While this may seem like a high EIRR, it is the expected result of a project providing financial and technical support to small enterprises. When given access to investment and working capital, these types of businesses can fully develop their capacities and generate huge returns compared to their baselines. The sensitivity analysis shows that this project is more sensitive to delays in benefits than increases in costs. Therefore, efforts to mitigate any risks that could result in project delays will be prioritized.

D. Sustainability

34. PACE will be the fourth IFAD-funded project implemented by PKSF and its partner organization network. It represents the consolidation phase of a process of progressive evolution of the IFAD-PKSF partnership in the area of microfinance for rural poor people. It will result in a sustainable network of microfinance institutions operating across the country and offering a diverse range of financial services tailored to poor clients in rural and peri-urban areas.

35. PKSF is in the process of mainstreaming non-financial services and has created a division within its organizational structure for non-financial service projects. This will ensure follow-up support beyond the PACE project period.

36. The sustainability of value chain development results will depend largely on the project’s effectiveness in facilitating linkages among stakeholders, especially between the target group and business partners in the value chain. The project will not use project funds for activities that could be funded by the value chain actors themselves. There is a particular risk of inhibiting the participation of private business, which is the major driver of the project; this will be avoided.

E. Risk identification and mitigation

37. Major risks relate to the overall health of the microfinance sector along with changes in microfinance policy. This risk is manageable since the core of the business is sound and the sector still growing, especially among the agriculture and microenterprise segments. Value chain development involves little risk: the approach has been well tested and will be spread across a number of sectors, regions and implementing partner organizations. Another potential risk relates to corruption; however this is considered negligible since PKSF has an excellent track record as an implementing agency, a rigorous and transparent fiduciary system, and a strong governance framework.

V. Corporate considerations

A. Compliance with IFAD policies

38. PACE is fully aligned with the IFAD Strategic Framework 2011-2015 and the current RB-COSOP for Bangladesh, which focuses on market access and value chains and on the economic empowerment of marginalized people. The project design adheres to IFAD’s policies for microfinance, private-sector participation, environment, targeting and gender. In accordance with the criteria for project categorization included in IFAD’s Administrative Procedures for Environmental Assessment, the project is classified as “B”.

B. Alignment and harmonization

39. The project is aligned with the Government’s sixth Five-Year Plan, which emphasizes rural employment, agricultural development, technology transfer to small producers and poor people’s access to financial services. The project will directly target the most productive rural population, microentrepreneurs in the

agricultural and non-agricultural sectors, facilitating the expansion of business and creation of wage employment. The project concept note and design report have been approved by the Government.

40. The design of PACE included a review of all relevant ongoing and past donor-funded value chain development projects in the country. IFAD supports the largest number of projects with a value chain development component. Other donors currently financing projects that involve value chain or sector development activities include the World Bank (National Agricultural Technology Project with cofinancing from IFAD); the Asian Development Bank (Second Chittagong Hill Tracts Rural Development Project and the Smallholder Cattle Development Project); the United Kingdom's Department for International Development (the Katalyst programme, Programmed Initiatives for Monga Eradication), Swiss Agency for Development and Cooperation (the Sambridhi programme), the United States Agency for International Development (USAID) and a number of international NGOs. However, not all projects have emphasized market development or private-sector participation to the same extent. The focus of these projects has largely been on small producers and farmers.

C. Innovations and scaling up

41. PACE represents a scaling up of successful interventions from previous projects. Through its three components, it will introduce a number of innovations: it will pilot new loan products such as lease finance, start-up loans and cluster financing, and it will disseminate new technologies to smallholder producers. Once they have proved successful, the innovations related to loans will be scaled up through PKSF's regular programme.

D. Policy engagement

42. Through component 2, PACE will facilitate discussion among national stakeholders on policy-related issues affecting the functioning of PACE-supported sectors and value chains. Policy dialogue will be clearly linked to knowledge management as policy-related issues will be based on a solid documentation of lessons learned and results of project-supported activities.

43. The project will: (i) strengthen the capacity of PKSF and partner organizations to identify policy issues during project implementation and address them through advocacy; (ii) use the initial analysis of selected sectors and value chains to identify important issues related to the policy and regulatory environment; (iii) finance additional analysis of particular issues either identified in the sector analysis or resulting from the implementation of PACE-supported value chain subprojects; (iv) facilitate regular opportunities for dialogue among the sector and value chain actors, ensuring the active participation of beneficiary representatives at the local level to discuss the functioning of value chains and identify issues for policy advocacy; and (v) promote national-level dialogue with the Government and industry associations to discuss these and any other issues.

VI. Legal instruments and authority

44. A financing agreement between the People's Republic of Bangladesh and IFAD will constitute the legal instrument for extending the proposed financing to the borrower. A copy of the negotiated financing agreement is attached as an annex.

45. The People's Republic of Bangladesh is empowered under its laws to receive financing from IFAD.

46. I am satisfied that the proposed financing will comply with the Agreement Establishing IFAD and the policies and criteria for IFAD financing.

VII. Recommendation

47. I recommend that the Executive Board approve the proposed financing in terms of the following resolution:

> RESOLVED: that the Fund shall provide a loan on highly concessional terms to the People's Republic of Bangladesh in an amount equivalent to twenty-six million three hundred and fifty thousand special drawing rights (SDR 26,350,000), and upon such terms and conditions as shall be substantially in accordance with the terms and conditions presented herein.

Kanayo F. Nwanze
President

Negotiated financing agreement: "Promoting Agricultural Commercialization and Enterprises (PACE)"

(Negotiations concluded on 3 September 2014)

Loan Number: [_______]

Grant Number: [_______]

Project Title: Promoting Agricultural Commercialization and Enterprises (PACE) (the “Project”)

The People’s Republic of Bangladesh (the “Borrower/Recipient”)

and

the International Fund for Agricultural Development (the “Fund” or “IFAD”)

(each a “Party” and both of them collectively the “Parties”)

WHEREAS the Fund has agreed to extend a loan to the Borrower/Recipient for the purpose of financing the Project, on the terms and conditions set forth in this agreement (the “Agreement”),

WHEREAS the Ministry for Food, Agriculture, Forestry and Fisheries of the Republic of Korea (the “Donor”) and the Fund have entered into a Supplementary Funds Arrangement dated 18 October 2012 (the “Arrangement”), pursuant to which the Donor intends to make available to the Fund a grant in order to provide supplementary financing to the Project,

WHEREAS the Donor has approved an umbrella programme document (the “Umbrella Document”) for the implementation of the Arrangement by exchange of letters with the Fund dated 15 May 2013, and

WHEREAS on the basis of the above and other considerations, the Fund has agreed to extend the grant from the Donor to the Borrower/Recipient for the purpose of increasing the financing in respect of the Project, on the terms and conditions set forth in the Arrangement, the Umbrella Document and this Agreement,

hereby agree as follows:

Section A

1. Without any limitation or restriction upon any of its obligations under this Agreement for the implementation of the Project, the Borrower/Recipient accepts, *mutatis mutandis*, the provisions of the Arrangement, as may be amended from time to time by the parties thereto, as valid and binding obligations of the Borrower/Recipient to the Fund.

2. The following documents collectively form this Agreement: this document, the Project Description and Implementation Arrangements (Schedule 1), and the Allocation Table (Schedule 2).

3. The Fund's General Conditions for Agricultural Development Financing dated 29 April 2009, as may be amended from time to time (the "General Conditions"), are annexed to this Agreement and all provisions thereof shall apply to this Agreement. For the purposes of this Agreement the terms defined in the General Conditions shall have the meanings set forth therein.

4. The Fund shall provide an IFAD loan (the "Loan") and a grant from the Donor (the "Grant") to the Borrower/Recipient (collectively the "Financing"), which the Borrower/Recipient shall use to implement the Project in accordance with the terms and conditions of this Agreement.

5. The Fund shall not be liable to the Borrower/Recipient in the event that the Grant, in whole or in part, is not available to the Fund. The Borrower/Recipient hereby undertakes to hold harmless and to indemnify the Fund for any such losses.

Section B

1. A. The amount of the Loan is twenty six million three hundred and fifty thousand Special Drawing Rights (SDR 26 350 000).

   B. The amount of the Grant is three hundred sixty thousand United States dollars (USD 360 000).

2. The Loan is granted on highly concessional terms, shall be free of interest but bear a service charge of three fourths of one per cent (0.75%) per annum and have a maturity period of forty (40) years including a grace period of ten (10) years.

3. The Loan Service Payment Currency shall be USD.

4. The first day of the applicable Fiscal Year shall be 1 July.

5. Payments of the principal amount of the Loan and service charge shall be payable on each 15 March and 15 September.

6. There shall be two (2) Designated Accounts, for the Loan and the Grant respectively and for the exclusive use of the Project, in the Bangladesh Bank (the "Central Bank of the Borrower/Recipient").

7. There shall be one (1) Project Account, denominated in Bangladeshi Taka, for the Loan and for the exclusive use of the Project, in a bank acceptable to the Fund.

8. The proceeds of the Financing shall not be used to finance taxes that may be due in connection with the Project. The Borrower/Recipient shall cause the Project Implementing Agency as defined below in Section C of this Agreement to make available to the Project counterpart funds from its own resources in an aggregate amount of twenty-two million four hundred fifty thousand United States dollars (USD 22.45 million) or its equivalent in accordance with this Agreement.

Section C

1. The Project Executing Agency shall be the Banking and Financial Institutions Division, Ministry of Finance of the Borrower/Recipient. The Project Implementing Agency shall be the Palli Karma-Sahayak Foundation (the "PKSF"), established as a not-for-profit Company under the Companies Act, 1913, as re-enacted in 1994 (Act 18 of 1994) and amended from time to time.

2. Additional Project Parties shall include, *inter alia*, institutions referred to in Schedule 1 to this Agreement.

3. The Project Completion Date shall be the sixth anniversary of the date of entry into force of this Agreement.

Section D

The Financing shall be administered and the Project supervised by the Fund.

Section E

1. The following are designated as additional general conditions precedent to withdrawal:

(a) The Designated Accounts and the Project Account referred to respectively in Sections B.6 and B.7 above shall have been duly opened; and

(b) The Fund's no-objection shall have been obtained to the Subsidiary Loan and Grant Agreement between the PKSF and the Ministry of Finance of the Borrower/Recipient.

2. The following are the designated representatives and addresses to be used for any communication related to this Agreement:

For the Borrower/Recipient:

Secretary
Economic Relations Division
Ministry of Finance,
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For the Fund:

President
International Fund for Agricultural Development
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This Agreement, dated ______________, has been prepared in the English language in six (6) original copies, three (3) for the Borrower/Recipient and three (3) for the Fund.

PEOPLE'S REPUBLIC OF BANGLADESH

____
[Name of the Authorized Representative]
[Title]

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

____
Kanayo F. Nwanze
President

Schedule 1

Project Description and Implementation Arrangements

I. Project Description

1. *Target Population*. The Project shall be carried out on the whole territory of the Borrower/Recipient (the "Project Area") and its target beneficiaries/population shall include microentrepreneurs, i.e. borrowers of the Microenterprise (the "ME") loan programme (non-poor), moderately poor and extremely poor people. In terms of professional identities, the Project shall target marginal and small farmers involved in field crops, horticulture, fisheries and other aquatic resources, livestock production, and other agricultural produce, and non-farm microentrepreneurs and professionals in related service sectors.

2. *Goal*. The goal of the Project is to enhance livelihoods (higher income from self-employment, business profit and wage employment, and food security) of the moderately and extremely poor Project participants in a sustainable manner.

3. *Objectives*. The objectives of the Project are to increase sales and incomes of existing and new microenterprises and to create new wage employment opportunities for extremely and moderately poor people.

4. *Components*. The Project shall consist of the following Components:

(a) *Component 1: Financial Services for Microenterprises.*

Under this Component, sustainable financial services for microenterprises (farm, off-farm, trading and related service sectors) shall be expanded. The outputs include: (i) expansion of microenterprise loans for the economic sectors of, *inter alia*, agriculture, off-farm, trading and services; (ii) piloting of new loan products; and (iii) capacity building of the Palli Karma-Sahayak Foundation (the "PKSF") and Partner Organizations of the PKSF (the "POs") in designing and developing of new financial products, monitoring, evaluation and impact assessment of the ME loan programme, and application of information technology in the management of the POs.

(b) *Component 2: Value Chain (VC) Development.*

The outcome of this Component is the sustainable inclusion of microenterprises in VCs in agriculture, off-farm and related service sectors to up-scale business, production technologies, and enhance access to markets. The outputs of the Component include: (i) established and expanded VCs of fifteen (15) agricultural sub-sectors (products or group of products); (ii) established and expanded VCs for fifteen (15) non-farm manufacturing, processing and service sub-sectors (products or group of products); (iii) strengthened capacity of the PKSF and the POs to manage large-scale VC sub-projects; (iv) enhanced capacity of the PKSF and the POs to identify, advocate and strengthen pro-poor business policies, especially sector specific policies; and (v) an internet based platform to transact products of microentrepreneurs.

(c) *Component 3: Technology and Product Adaptation.*

The outcome of this Component is proven technologies and products (agricultural and off-farm) from Bangladeshi and international sources introduced to microentrepreneurs. The outputs include: (i) resolution of technological problems identified under Component 2; (ii) adaptation and dissemination of proven technologies and products; and (iii) provision of technical assistance.

II. Implementation Arrangements

5. *Project Implementing Agency.* The PKSF, in its capacity of the Project Implementing Agency, shall take the overall responsibility of the Project implementation as accorded to a Lead Project Agency in accordance with the General Conditions.

6. *Annual Work Plans and Budgets (the "AWPBs") and Procurement Plans*.

(a) The Project Implementing Agency shall prepare a draft AWPB for each Project Year. Each draft AWPB shall include, *inter alia*, a detailed description of planned Project activities during the coming Project Year and a Procurement plan and the sources and uses of funds. The first Procurement plan shall cover the initial eighteen (18) month period of Project implementation, while the subsequent plans shall cover succeeding twelve (12) month periods. Each draft AWPB shall be submitted to the Project Executing Agency for approval. If the Project Executing Agency does not comment on the draft AWPB within thirty (30) days of receipt, the AWPB shall be deemed so approved by the Borrower/Recipient.

(b) Once approved in accordance with paragraph (a) above, the Project Implementing Agency shall submit the draft AWPB no later than sixty (60) days prior to the beginning of the relevant Project Year to the Fund for its comments and approval. If the Fund does not comment on the draft AWPB within thirty (30) days of receipt, the AWPB shall be deemed acceptable to the Fund.

7. *Subsidiary Loan and Grant Agreement (the "SLGA")*. The PKSF shall enter into an SLGA with the MOF to receive the Financing in the form of loan and grant for the implementation of the Project.

8. *Responsibilities of the PKSF*. The PKSF shall, *inter alia*, (i) ensure a VC Unit in the PKSF with adequate personnel, resources and authority to manage and oversee the development of sustainable VCs within the Project; (ii) organize and fund capacity building of its own staff as well as the POs and VC actors; (iii) provide and supervise the funding of the ME loan programme and other financial products to the POs; (iv) identify potential VCs and contract out sector and marketing studies; (v) provide guidance to the POs in the preparation and management of VC promotion; (vi) contribute to the preparation of VC proposals by the POs by providing general guidance and relevant sector and marketing studies; (vii) share experiences with other VC development agencies/projects and rationalise common activities; (viii) engage in the introduction of necessary and appropriate changes in relevant laws, rules and standards; (ix) identify suitable technical assistance organizations or individual experts to provide capacity building to the PKSF staff, the POs, VC actors and actors' associations; (x) supervise and monitor VC sub-projects; and (xi) conduct Project assessment and impact studies.

9. *POs*. The ME loan programme under Component 1 and activities under Component 2 shall be implemented through the POs. The POs may participate in dissemination of technologies under Component 3 to the target population.

10. *Responsibilities of the POs*. POs shall, *inter alia*, (i) carry out by themselves or outsource to a qualified service provider an initial mapping of key actors in each selected VC (including, *inter alia*, producers, service providers, input suppliers and traders), marketing channels as well as actors' associations; (ii) prepare proposal(s) for individual VC development and their scaling up; (iii) provide and manage ME loan programme and other financial products for producers and entrepreneurs; (iv) assume responsibility for guiding the sustainable development of the specific VCs (particularly in the pilot phase) with special attention to addressing the major VC constraints identified in the VC

proposal; (v) ensure the availability of competent service providers to other actors in the VC and link them to such actors; (vi) advise producers regarding, *inter alia*, access to the market and input suppliers; (vii) facilitate services to producers from the private sector to be paid for in full by the producers (if private services are not available, the POs shall promote and develop private services; if that is legally impossible, the POs shall facilitate services from the government agencies); (viii) disseminate farm and non-farm technologies; and (ix) monitoring and evaluation and reporting, including identification of lessons learnt.

11. *Project Management Unit (the "PMU").* An appropriately staffed PMU to implement the Project shall be established. The PMU shall work through officers of the PKSF's Loan Operations Division (the "LOD") to implement the ME loan programme. The LOD shall implement the ME loan programme as per established processes and norms through the POs. The PMU shall take the lead role in organizing, implementing, supervising and monitoring all activities under Components 2 and 3. The PMU shall help the POs develop VC development proposals, review and negotiate with the POs and obtain approvals for proposals by the VC Project Approval Committee of the PKSF which is composed of senior PKSF officers. The process shall serve to ensure transparency, bring additional expertise, establish linkage with the LOD and support consistency among all projects. The authority on relevant financial approvals shall rest with the Managing Director of PKSF. The PMU shall determine the needs for external technical support and technology and product for promotion, and shall engage with appropriate external partners for implementing activities under Component 3. The PMU shall further take the lead on the organization of all training and studies and other incidental work of the Project.

12. *PMU staffing*. The PMU shall have four (4) categories of professional staff: (i) a Project Coordinator who shall be a senior permanent PKSF official deputed to the Project; (ii) directly recruited professionals as Assistant Managers/Deputy Managers to be trained to manage and supervise all VC development and other activities of the Project; (iii) senior professionals for farm and non-farm sectors as VC development specialists who shall advise the Project Coordinator and other professionals in VC development, technology and product adaptation activities and private sector partnership; and (iv) mid-level professionals in areas such as monitoring and evaluation, procurement, financial analysis and accounting. The professional staff of categories (iii) and (iv), contracted for the Project, are expected to leave the Project after its completion. The professional staff of category (ii) are expected to become regular staff of the PKSF that would enhance the PKSF's capacity to implement programmes of non-financial services.

13. *Project Implementation Manual (the "PIM")*. The PKSF shall prepare a draft PIM for the Fund's consideration and approval. Once approved, the PIM shall be followed in the implementation of the Project. The PIM shall include rules and procedures on, *inter alia*:

(i) qualifications, terms of reference and detailed implementation responsibilities of Project Parties including, *inter alia*, the recruitment of professional staff of the PMU, consultants and service providers;

(ii) budgeting, expenditure approvals, use of chart of accounts, and overall accounting and reporting framework;

(iii) financial controls, stringent asset management controls, thorough internal and external audit function, detailed mechanisms for reporting of fraud and corruption and related management actions as per the Fund's policies and rules;

(iv) national competitive bidding in line with the provisions of IFAD's Project Procurement Guidelines and Procurement Handbook;

(v) limited competitive bidding from the list of prequalified companies and services providers;

(vi) shopping and direct contracts;

(vii) procurement arrangements of the POs;

(viii) composition of procurement evaluation committees; and

(ix) monitoring and evaluation.

The PIM may be amended from time to time, subject to approval by the Fund.

14. *Mid-Term Review (the "MTR")*. An MTR shall be conducted during the third year of implementation on, *inter alia*, the physical and financial progress in comparison with AWPBs, the impact achieved in all three (3) Components and the results of technical assistance and training activities.

Schedule 2

Allocation Table

Allocation of the Loan and Grant Proceeds.

(a) The Table below sets forth the categories of eligible expenditures to be financed by the Financing and the allocation of the amounts of the Financing to each category and the percentages of expenditures for items to be financed in each category:

Category	Loan Amount (SDR)	Grant Amount (USD)	% of Eligible Expenditures to be Financed
I. Equipment	120 000		100% net of Taxes
II. Credit Fund	12 100 000		100% net of Taxes, PKSF and POs' contributions
III. Consultancies	9 380 000	360 000	100% net of Taxes
IV. Salaries	1 650 000		100% net of Taxes
V. Operating costs and maintenance	470 000		100% net of Taxes
Unallocated	2 630 000		
TOTAL	**26 350 000**	**360 000**	

(b) The terms used in the Table above are defined as follows:

"Equipment" covers eligible expenditures for vehicles, office equipment, furniture and goods.

"Credit Fund" covers eligible expenditures for financial services for the ME loan programme through selected POs.

"Consultancies" includes eligible expenditures for training, workshops, meetings, technical assistance and VC development activities.

Logical framework (excerpt)

Design Summary	Performance targets and indicators	Monitoring mechanism & information sources	Assumptions
Project Goal Enhance livelihoods (higher income from self-employment, business profit and wage employment, and food security) of the moderate and extreme poor (men and women) in a sustainable manner.	• 60% of households report improvements in household asset ownership index • 50% increase in income of 70% participating moderate and extreme poor households from farm, non-farm and service type businesses and wage employment	Impact surveys of households at baseline, mid-term and completion qualitative (participatory rapid appraisal) assessment of participating households and quantitative assessment (profitability analysis) of microenterprises	• Economy maintains or increases growth rates. • Terms of trade for rural communities does not deteriorate. • Price inflation for staple food (rice) remains below 10%. • Rural and peri-urban infrastructure improves. • Prolonged political unrest does not hinder business and other economic activities.
Development objective Increase sales and incomes from existing and new microenterprises, and create new wage employment opportunities for extreme and moderately poor people.	• 300,000 microenterprises (out of which 210,000 are owned by women) have increased combined sales by 50% after receiving credit and technical support • 13,000 new wage employment positions and taken up by moderately and extremely poor people (x are women).	PACE project annual assessment report on business expansion and employment creation; impact assessments; PRA assessments	• Government maintains pro-small business policies. • Government continues to support microfinance programs and NGO activities. • Prolonged political unrest does not adversely affect business and economic growth.
COMPONENT 1: Financial services for microenterprise			
Outcome 1: Sustainable financial services for MEs* (farm, off-farm, trading and service sectors) expanded.	• PKSF's portfolio in ME program increases by at least BDT 3.2 billion. • PO portfolio in ME loan programme increases by BDT 5.6 billion. • 60% of POs offer the new products 24 months after the first introduction by PKSF	PKSF's programme/financial reports; POs programme/financial reports; PACE project report	• Demand for microenterprise loans grows. • POs remain institutionally and financially viable and offer competitive loan products. • No major external shocks such as major spread of disease occur.
COMPONENT 2: Value chain development			
Outcome 2: Sustainable inclusion of MEs and businesses in value chains in agriculture, off-farm and service sectors to up-scale business, production technologies, and enhance access to markets.	• BDT 9 billion increase in cumulative sales of participating businesses (farm and non-farm sectors) in value chains • 270,000 microenterprises operating three years after the support received from the project	Impact assessment of value chains; Project reports and impact assessments; Case studies	• PKSF and POs remain committed to facilitating non-financial services along with financial services. • PKSF and POs successfully establish collaborative business arrangements between MEs and mainstream businesses. • No major external shocks such as disease occur.
COMPONENT 3: Technology and product adaptation			
Outcome 3: Proven technologies and products introduced to MEs.	15 technologies and products successfully introduced to small producers	Independent assessment reports; PACE reports	PKSF and POs successfully identify technologies and products for small producers within and outside value chain subprojects.

* ME microenterprise (as defined by PKSF under its loan programme).