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Investing in rural people

IFAD Private Sector Engagement Strategy 2019-2024

Comments of the Independent Office of Evaluation of IFAD

Note to Executive Board representatives

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IFAD Private Sector Engagement Strategy 2019-2024: Comments of the Independent Office of Evaluation of IFAD

I. Introduction and general comments

1. The Independent Office of Evaluation of IFAD (IOE) welcomes the opportunity to provide comments on the Private Sector Engagement Strategy 2019-2024. IOE completed a corporate-level evaluation (CLE) of IFAD's Private Sector Development and Partnership Strategy in 2011, a CLE on IFAD's financial architecture in 2018 and a CLE on IFAD's engagement in pro-poor value chain development in 2019. It also completed an evaluation synthesis on building partnerships for enhanced development effectiveness in 2018. These evaluations are relevant to the Fund's private sector engagement.

2. Expanding into private sector financing may at first glance seem to be a major "game changer" for IFAD. However, it is important to realize that IFAD is not alone in this effort: many development finance institutions are active as private sector lenders and investors in agriculture. Moreover, IFAD approved its first Private Sector Development and Partnership Strategy in 2005 and has 15 years of experience in this area.

3. The strategy highlights the funding gap between the estimated financial resources required to achieve Sustainable Development Goal (SDG) 2 and projected official development assistance. The strategy also notes the challenges that the private sector faces in engaging with smallholder farmers and rural micro, small and medium-sized enterprises (MSMEs), and the need for public funding to facilitate such engagement. Quoting past evaluations, it underscores that IFAD currently lacks the financial instruments to engage directly with private sector entities.

4. Relevance of the objectives. The two objectives proposed by the strategy are relevant to IFAD's mandate of rural poverty reduction. These objectives are to: (i) mobilize private funding and investments into rural MSMEs and smallholder agriculture; and (ii) expand markets, income and job opportunities for IFAD's target group.

5. While the two strategic objectives are relevant, the two actions under objective 1 ("Deploy financial instruments that play a catalytic role in directing private sector financing into rural MSMEs and small-scale agriculture"; and "Use IFAD's programme of loans and grants to crowd in private sector investments") are better elaborated upon than the two actions under objective 2 ("Develop inclusive value chains with private sector partners"; and "Test and scale up new technologies and cost-effective solutions"). The latter are defined in generic terms and it is not clear in what way they depart from "business as usual" or IFAD's previous experience.

6. While the implementation modalities proposed by the strategy (scaling up engagement with the private sector gradually; ensuring country ownership; avoiding mission drift and maintaining selectivity and focus; working with other development partners, the Rome-based agencies and other United Nations agencies; seeking additional resources and avoiding substitution risk; and allocation of amounts for private sector interventions not based on the performance-based allocation system) are reasonable, they are more general principles than operational modalities.

7. Balance in strategic content. Overall, the strategy focused on the introduction of non-sovereign lending – by far the most important new development – and the identification of resources that could be mobilized for this type of lending. The rest of the strategy presented less innovative modes of action. The strategy could have been more valuable if it had explored in-depth the experiences available to IFAD

and proposed more concrete actions. In addition, areas such as policy engagement and capacity-building at IFAD and in the countries where it works could have been touched upon.

8. Size of the envisaged operations. IFAD's new private sector activity will be relatively limited in terms of volume. Considering that an additional US$180 billion each year is needed to tackle SDG 2 alone, the 5 per cent of IFAD's capital that it plans to contribute from its own resources for its private sector activities is very small.

II. Specific comments

9. Closer links to value chains. IFAD has experience in value chain development and the strategy makes some reference to it. A far stronger emphasis in this area – focusing on the gaps in cooperation with private sector entities and the financing of value chains – would add credibility to IFAD's Private Sector Engagement Strategy. To this end, the strategy could have drawn more from the recent CLE on IFAD's engagement in pro-poor value chain development. It could also have responded more directly to that CLE's recommendations, for example by: (i) laying out key principles for value chain development (recommendation 1); (ii) confirming IFAD's commitment to promote inclusive value chain governance and a regulatory environment (recommendation 4); (iii) discussing (with further elaboration in an annex if necessary) enhanced approaches to value chain financing (recommendation 6); and (iv) developing the capacity of IFAD staff and project managers to work with private sector entities for pro-poor value chain development (recommendation 7). Maintaining a focus on poor and very poor communities is of special importance.

10. A niche for IFAD in non-sovereign lending. Finding the right niche will be extremely important for IFAD; however this is not clearly explained in the document. For example, the "low-volume end" of non-sovereign lending is already today covered by microfinance institutions. IFAD can contribute to strengthening these institutions by providing them with long-term loan funding, allowing them to extend their outreach. Such long-term funding must be in local currency since microfinance institutions should not lend in hard currency, which would expose their clients to foreign exchange risk. The "mid-range" of non-sovereign lending is a grey area that is too small for banks and has proved commercially difficult. This area is covered by a number of impact investment funds that provide financing to smallholder farmers and their organizations (including cooperatives). Impact investors (of which only a few were consulted for the strategy, as shown in appendix I) operate commercially: while their main focus is not on maximizing profits, they seek a clear social impact. IFAD could also consider providing first-loss financing for "difficult" loan portfolios. Finally, financing longer-term capital investments as part of IFAD's support to value chains would help smallholder farmers and their organizations without causing mission drift.

11. Additionality and avoiding "crowding out". In IFAD's private sector approach, it will be important (as recognized in annex II of the strategy) for IFAD to ensure that its interventions are additional to what the market offers and do not crowd out existing players by undercutting them commercially. Instead, IFAD should seek to cooperate with focused impact investors and local banks and microfinance institutions in order to assist private sector actors with a mandate to assist IFAD's core clients.

12. Partnering and external institutions consulted. It is important to note that appendix IV includes an important statement regarding IFAD's approach: "Initially, and in line with the gradual approach to private sector operations, IFAD is primarily planning to reach out to the smallholder agriculture sector indirectly, i.e. through financial intermediaries that have so far been unable to provide funding to this target group". It is not clear why IFAD would seek to work with institutions that

have not managed to reach smallholders when there are established institutions with significant expertise in reaching these clients. If institutions are not successful in this area, it is usually because of a lack of competence or too-high profit expectations. IFAD should instead seek to cooperate with institutions that already work with smallholder farmers.

13. While the list of consulted institutions is long, the Council on Smallholder Agricultural Finance (CSAF) and other key players focused on smallholder farmers are missing. CSAF is an alliance of social lending institutions (also referred to as "impact-first" agricultural lenders) whose primary goal is not to maximize profits, but to have a positive impact on IFAD's target clients. They are therefore natural partners for IFAD in terms of investment focus and alignment of investment goals. Moving forward, it will be important for IFAD to choose partners with track records that are directly relevant to its work.

14. Funding and fund-raising. It is optimistic to assume that IFAD can expand its private sector fund-raising to raise money for private sector activities from non-governmental sources without first: (i) developing a track record or hiring teams that have a track record; (ii) building the right infrastructure; and (iii) investing a significant amount of its own capital in each project. Few private sector institutions would fund an entity with no private sector track record. If IFAD is to be credible in private sector investment, it has to allocate its own resources to the sector.

15. Risks. Lending to or investing in the private sector implies taking risks. The statement that "IFAD will … mitigate all the risks stemming from engaging with the private sector" is slightly misleading. IFAD has to recognize that taking credit risk in private sector operations will lead to loan losses, which have to be covered by capital. Structuring projects correctly is crucial to the success of any private sector activity.

16. Human resources and capacity-building. Private sector lending is very different from public sector lending. IFAD will need to hire: (i) competent professionals with private sector emerging market agricultural lending experience; (ii) lawyers who can structure transactions; and (iii) staff of an independent credit department with private sector experience. In most development finance institutions, projects are structured from the business perspective; here, IFAD needs to build expertise. In addition to IFAD staff, capacity-building of government and project staff is also needed to foster collaboration between sovereign and non-sovereign operations, as envisaged by the strategy

17. Financial resources. The strategy is missing a budget, including information on: (i) how many staff will be hired at what cost; (ii) how many projects are anticipated in the coming years and their size; and (iii) expected loan losses and how they are going to be covered. The assumption that this new area of work can be "budget-neutral" does not appear realistic.

18. Impact evaluation. Similar to the impact assessment of the Yield Uganda Investment Fund, IFAD should begin by analysing the social and economic impacts of its private sector investments, employing cutting-edge impact assessment methodologies. It is important to undertake independent impact studies from the start of each project in order to collect long-term data with a view to establishing adequate baselines and control groups for comparative impact assessment.

III. Final remarks

19. There is no doubt that engaging with the private sector is necessary to contribute to the transformation of rural economies, and for IFAD to be seen as a relevant and credible partner. In its current formulation, the strategy is not very ambitious, but can be seen as a small step in the right direction. It can be viewed as a pilot for IFAD to learn lessons from.

20. The strategy's value proposition could be enhanced by linking it more strongly with IFAD's work on value chains; the recommendations of the recent CLE are an important point of departure. Although non-sovereign lending can be an important ingredient of engagement with the private sector, this broad area involves changes in the design of "traditional" projects, capacity-building of government and project staff, and engagement in policy dialogue. These issues will need to be defined at IFAD.