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Investing in rural people

Private Sector Financing Programme

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Consultation on the Twelfth Replenishment of IFAD's Resources —
Third Session

Rome, 19-21 October 2020

For: **Review**

A. Background

1. With only 10 years left to achieve the Sustainable Development Goals (SDGs) and progress to end extreme poverty and achieve food security now stalled, IFAD needs to step up its impact. The business model agreed for the Twelfth Replenishment of IFAD's Resources (IFAD12) period seeks to strengthen IFAD's support for those most at risk of being left behind. It will focus on delivering a transformational country programme approach whereby the Private Sector Financing Programme (PSFP) will complement IFAD's regular sovereign lending and grant programme, along with the Rural Resilience Programme (2RP). The aim is to expand IFAD's resources and means of engagement and deepen impact, especially in the countries most vulnerable to climate change, fragility and food insecurity, to create a comprehensive programme of work.
2. Addressing the challenges of attracting private sector investment in agriculture and creating inclusive business models – particularly in low-income countries (LICs), lower-middle-income countries (LMICs) and fragile countries – requires an investor with a deep understanding of the agriculture sector and related needs, ecosystem and de-risking opportunities. IFAD is the only specialized global development organization exclusively dedicated to transforming agriculture, rural economies and food systems to make them more inclusive, productive, resilient and sustainable.
3. Unlike commercial investors, and some larger international financial institutions, IFAD targets the "last mile" and the remotest areas to help millions of rural people increase their productivity and incomes, access markets and create jobs, despite the challenges and risks associated with serving this market segment. As an investor, IFAD has been and continues to be able to leverage on its experience and expertise and is willing to take risks to transform rural economies and food systems.

**IFAD is uniquely positioned to deliver its
Private Sector Finance Programme:**

- Exclusive focus on rural development and deep understanding of rural sector needs;
- Privileged access to data on farmers and agricultural ecosystems;
- Higher-risk appetite with a focus on small-scale producers;
- Reputation as trusted partner with the both the private sector and governments;
- Designed portfolio approach to investing with intent to create linkages with public sector projects;
- Patient investment horizon;
- Proven assembler of development financing;
- Transparent and strong impact measurement frameworks.

B. Objectives

4. The objective of the PSFP is to enable IFAD to scale up its impact and contribution to achieving zero rural poverty and hunger (SDG 1 and 2) by complementing and strengthening the results delivered through its sovereign programme of loans and grants (PoLG). This will entail a move from an ad-hoc approach to private sector development and mobilization of private sector funding and know-how for the SDG 1 and 2 agenda to a broader and institutionalized programme that will raise the visibility and scale of IFAD operations. Additionally, the PSFP will contribute to IFAD's long-term financial sustainability by generating income that will contribute to the expansion and diversification of its resource base, in line with the ongoing efforts with the new financial architecture.

C. Outcomes and results targets

5. The PSFP seeks to crowd in private sector investments, know-how and innovation for the benefit of small-scale producers and rural communities, with a focus on job creation for youth, female empowerment and strengthened resilience to climate change.
6. This crowding-in effect will be achieved by de-risking private sector investments in two ways: first, by utilizing IFAD's extensive expertise and know-how in the agricultural sector and working in the poorest areas of developing countries; second, by leveraging the PSFP resources, which IFAD seeks to mobilize from various types of donors and impact investors. IFAD's aim is to achieve a 5x cofinancing/leveraging ratio from funding mobilized for the PSFP.¹ This means that every single dollar provided in support of the PSFP would translate into five dollars directly invested toward the objective of increasing global commitments to agriculture and food security in the poorest regions.
7. Overall, depending on the amount of resources raised, the PSFP will reach between 2.5 and 5 million beneficiaries. The positive impact of successful private sector projects can include creating thriving businesses that offer jobs and livelihoods to lift populations out of poverty and augment human capital through training. Greater use of technology by small and medium-sized enterprises can increase their efficiency and yields and decrease negative environmental impact. The PSFP will also support small-scale producers in building resilience capacities and adapting to climate change through diversified farming and livelihood systems, adopting agro-ecological practices and nature-based solutions enhancing biodiversity, and mitigating greenhouse gas emissions.

D. Eligible countries and projects

8. All countries where IFAD operates will be eligible for PSFP projects. In line with IFAD's mandate and corporate commitments, PSFP projects and activities will focus in particular on LICs, LMICs and countries in fragile situations, with an indicative target of 90 per cent of PSFP investments targeting these countries in the first three years of operations (IFAD12 period 2022-2024).
9. PSFP resources will not be allocated under the Performance-based Allocation System. Five criteria will be used to ensure a targeted and broad diversification of resources across geographies and Member States with a focus on those most in need: (i) relevance to IFAD's mandate and complementarity with the PoLG; (ii) IFAD's additionality; (iii) expected development results; (iv) risk; and (v) environmental, social and governance standards. Potential for achieving a high catalytic effect and leverage will also be a key consideration in the selection process.
10. The PSFP plans to ramp up its offerings over time with the use of three financial instruments: debt, equity and risk mitigation products. The PSFP also calls for the use of technical assistance to complement and enhance PSFP-sponsored investment projects.

E. Governance and resource mobilization

11. IFAD's ambition is to raise, through the IFAD12 replenishment and other resource mobilization efforts, up to US\$200 million in funding to kick-start the PSFP. This capital is needed to de-risk private sector investment projects. PSFP resources are expected to catalyse up to five times their value in investment from the private sector and other investors (equivalent to US\$1 billion) for the benefit of poor rural households and small-scale producers. This is particularly important in the current context where scaled-up action is needed to address the negative effects of

¹ The 5x leveraging is calculated as the ratio between IFAD's own investment and the total cost of the project being supported.

COVID-19 and their increasing burden on public finances of several developing Member States.

12. Depending on the outcomes of the IFAD12 Replenishment Consultation, PSFP contributions could be recognized as a form of vote-bearing “additional contributions”. Member States may also provide supplementary funds to the Private Sector Trust Fund (PSTF), which do not give rise to voting rights. Contributions from non-Member States will also be sought but will not provide voting rights or any other rights regarding the Executive Board. In order to minimize substitution risk, the Fund calls upon Member States to make every effort to maximize their core contributions before contributing to the PSFP.
13. Donors and investors providing resources to the PSTF will be given an opportunity to contribute to its governance. Overall, the governance of PSFP projects will be based on IFAD’s non-sovereign operations (NSO) project-level approval process, with ultimate approval by the Executive Board. In addition, a dedicated PSFP advisory committee will be created to provide strategic input and guidance at the programme level. The advisory committee will be comprised of representatives of PSFP contributors.

F. Financial sustainability

14. The PSFP will generate a number of income streams to cover operational costs and grow the pool of funding for future investments and activities. Successful projects will generate repayment of principal amounts (in the case of non-equity investments) as well as interest income and fees earned. For equity, value added and dividends are expected. These investment reflows will be used as a source of investment capital and technical assistance funding for the PSFP. In line with document EB 2020/129/R.11/Rev.1, Framework for IFAD non-Sovereign Private Sector Operations and Establishment of a Private Sector Trust Fund, incremental administrative expenditures incurred by IFAD in relation to PSFP shall be paid from the resources of the trust fund.
15. Based on a 10-year model, the PSFP is expected to generate sufficient income to cover costs by the year 2024 with minimum resources mobilized of US\$64 million for the investment portfolio. An initial up-front investment of US\$3 million will also be required over this period until sufficient income flows are generated to cover costs.
16. After 2024, it is expected that PSFP investments and activities will generate net positive income for IFAD – up to US\$16 million in income from interest and fees over 10 years. The PSFP will thus be in a position to replenish itself for further investments over time. The PSFP will seek to finance projects on a commercial basis as a first investment principle, however it will also use the grants mobilized to deploy blended finance solutions when deemed appropriate from an impact and risk perspective, in accordance with best practice principles.²

G. Results framework

17. Contributions to the PSTF, which will host dedicated resources for the PSFP, will be traceable and a reporting mechanism will be put in place to allow for clear and transparent monitoring and reporting on both financial and development impact performance. Estimated development impact figures are reported for three different PSFP funding scenarios in table 1.

² IFAD adheres to the Development Finance Institutions Enhanced Principles for Blended Concessional Finance in Private Sector Projects.

Table 1
Expected leverage and outreach by EOY 2024

| | <i>Break even</i> | <i>Medium</i> | <i>High</i> |
|--------------------------------------|--------------------------|---------------------------|---------------------------|
| Amount raised | US\$67 million mobilized | US\$100 million mobilized | US\$200 million mobilized |
| Total amount with leverage (5X) | US\$335 million | US\$500 million | US\$1 billion |
| NSO projects | 18 | 25 | 33 |
| Average size of NSO projects | US\$4 million | US\$6 million | US\$10 million |
| Percentage of NSOs in LICs | 90 | 90 | 90 |
| Small producers reached | 1.7 million | 2.5 million | 5 million |
| Percentage of women small producers | 50 | 50 | 50 |
| Total number of beneficiaries | 8.4 million | 10 million | 25 million |

H. Way forward

18. The first contributions to the PSFP are expected to be received during 2021. The first advisory committee meeting will be held by the second quarter of 2021. Information on the PSFP will be made available on the IFAD website, and an update on the PSFP, including with regard to resource mobilization, implementation and results, will be included in the IFAD12 Midterm Review.