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Enabling poor rural people
to overcome poverty

IFAD's response to the emerging role of the private sector

Consultation on the Eighth Replenishment of IFAD's
Resources — Fourth Session
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For: **Review**

Note to Consultation Members

This document is submitted for review by the Consultation on the Eighth Replenishment of IFAD's Resources.

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Abbreviations and acronyms

PSDP	Private-Sector Development and Partnership Strategy
MSME	micro, small and medium enterprises
MFI	microfinance institution
IFI	international financial institution
AfDB	African Development Bank
IFC	International Finance Corporation

Executive summary

1. This paper has been prepared in response to requests from IFAD Member States for a discussion of possible IFAD responses to the fast-growing role of the private sector in developing countries' rural economies. The purpose of the paper is to set out the issues and options for an IFAD response during the Eighth Replenishment period (2010-2012).
2. Agricultural production and processing, and rural economic activities in general, have traditionally been, and will continue to be, private-sector endeavours. While smallholder farmers are part of the private sector, they also interact on a daily basis with larger private-sector operators and the corporate private sector (i.e. commercial companies) for the delivery of agricultural services, inputs, finance and markets. As a result, increasing agricultural production, sustainably raising the incomes of poor rural people and promoting their empowerment is heavily – and increasingly – dependent on the vibrancy, performance and investments made by the corporate private sector and larger private-sector actors.
3. At the same time, the expectation that agricultural commodity prices will remain high for at least the next 10 to 15 years, together with related concerns over food security, have spurred the interest of sovereign wealth funds and private investment vehicles alike in investing in agriculture. These trends could usher a new era and opportunities to ensure that smallholder farmers and rural communities are part of the solution to the current food crisis, by jointly promoting partnerships between small farmers and private-sector commercial interests.
4. IFAD needs to respond with flexibility and agility to the growing role of the private sector in poor rural areas and to the opportunities that are emerging to harness new sources of funding for the benefit of poor rural people. While there are risks associated with new approaches, and these will need to be very carefully managed, direct support to the private sector is also expected to bring substantial benefits to IFAD's target group of poor rural producers in terms of broadened economic opportunities.
5. The Agreement Establishing IFAD confines IFAD's financing to developing Member States or intergovernmental organizations. While much can and has been done to work with the private sector in the context of the Fund's current business model and within the framework of IFAD's existing Private-Sector Development and Partnership (PSDP) Strategy, much more could be done if IFAD were able to engage the private sector on the basis of a broader and more flexible set of business models and financial instruments.
6. Given the above, IFAD proposes to:
 - (i) Increase the level of engagement with the private sector within the existing PSDP strategy and within IFAD's regular programme.
 - (ii) Explore with potential partners, taking into account the institutions and facilities that already exist, the need for a new facility to promote private-sector investment in rural areas. If such a need is identified, a proposal will be prepared and presented for approval to IFAD's Executive Board by December 2009.
 - (iii) Assess the need, value added and feasibility of IFAD developing new instruments to engage directly with the private sector, including through non-sovereign lending and equity investments. To this end, and taking account of the experience in exploring the above facility, IFAD will present to the Executive Board, by December 2011, a review analysing the experience of other international development agencies that have adopted such an approach.

IFAD's response to the emerging role of the private sector

I. Introduction

1. This paper has been prepared in response to requests from IFAD Member States for a discussion of possible IFAD responses to the emerging role of the private sector in developing countries' rural economies. The purpose of the paper is to set out the issues and options for an IFAD response during the Eighth Replenishment period (2010-2012). The paper starts by describing the growing role of the private sector in rural economies, and its relationship to IFAD's mandate and target groups. It then describes IFAD's comparative advantage and potential future role in working with the private sector (including some of the challenges and risks involved), and proposes a set of activities to be undertaken during the Eighth Replenishment period.

II. The growing role of the private sector in rural economies

What constitutes the private sector in rural areas?

2. Agricultural production and processing, and rural economic activities in general, have traditionally been, and will continue to be, private-sector endeavours. The private sector in rural areas includes both the smallholder farmer and the corporate private sector (i.e. commercial companies), as well as many other types of operators, entities and organizations. In fact, with economic development, the rural private sector has grown in diversity and complexity, and usually consists of a continuum of economic agents ranging from subsistence or smallholder farmers to larger farms, including plantations; micro, small and medium enterprises (MSMEs) engaged in agroprocessing or in the supply of farming inputs and tools; local, regional or international traders; fertilizer and seed suppliers and distributors; and larger-scale agribusinesses. The sector also comprises financial institutions, including microfinance providers, extending finance to farms and rural enterprises. NGOs, associations of producers and cooperatives also constitute an important element of the rural private sector.

Recent developments

3. The economic and institutional environment prevailing in rural areas has changed radically over the past 20-30 years. Rural areas have been strongly affected by the progressive integration of local economies at the national, regional and global levels. Agricultural markets have grown significantly, largely on account of higher urban demand for food products, and private enterprises are now ubiquitous in rural areas. New economic players, including regional and international traders and food processors, have emerged or are now active within the rural areas rather than just operating from the periphery. Agroprocessing companies, in particular, play a crucial role in the development of rural economies by establishing critical supply chains and opening up new employment opportunities in their areas of operation. As agroprocessors and traders expand their operations, and hence their purchases of agricultural products, in response to the higher demand for food, new opportunities are being created for smallholders to earn more for their produce.
4. Accompanying these emerging opportunities, there are of course some risks and challenges facing small farmers and other rural poor people. These include the growing displacement of small farms by both large farms and the well-connected; the fact that small farmers may be excluded from access to commercial markets because it is too costly for the larger private-sector operators (i.e. the "corporate private sector") to deal with a multitude of dispersed smallholders or because small farmers lack the capacity to supply products on a consistent and timely basis; and

the potential unequal relationship between small rural producers and the more powerful corporate private sector resulting in exploitative and unfair business practices.

5. The organizational set-up has also changed considerably in terms of farmers' access to services. While agricultural services such as extension, credit, input supply and marketing used to be provided mostly by the public sector, agroprocessing and trading companies are now a major source of agricultural inputs, technical advice and financial services for farmers, besides providing them with a market outlet. For example, with the rise of integrated supply chains and contract farming, processing companies and traders are becoming an important source of agricultural credit as input credit schemes become critical to their ability to secure the timely delivery of high-quality raw materials. NGOs have also become key providers of services for communities lacking access to commercial intermediaries. As a result, in many countries, the government is no longer the predominant source of technical, financial and marketing services to farmers. This trend can be expected to gain further momentum in the future, with governments shifting their operational focus towards agricultural research and the provision of local infrastructure and social services (health, education).
6. The expectation that agricultural commodity prices will remain high for at least the next 10 to 15 years, together with related concerns over food security, has spurred the interest of sovereign wealth funds (government-owned investment funds) and private investment vehicles alike in investing in agriculture. While this runs the risk that small farmers' land may be seized by powerful interests, there is growing recognition that smallholder farmers and rural communities are part of the solution to the current food crisis. This is an area where private-sector commercial interests and developmental objectives can be pursued jointly by promoting partnerships between small farmers and large-scale farming operations or agribusiness companies.
7. Another rising trend, reflecting the increased sophistication of consumers, is the food industry's growing concern about the environmental footprint of agricultural production, the quality and safety of food products, and the labour conditions under which they are produced and processed. As market certification increasingly demands production performance tests, food producers are led to introduce control systems to guarantee the traceability and quality of agricultural inputs. As a result, the marketing of agricultural products has become as much a matter of meeting certain quality standards as of setting mutually acceptable prices between producers and buyers. Expanding markets, and higher commodity prices, should provide producers with significant opportunities for income growth. Gaining and maintaining market access, however, will require that they maintain increasingly tight sanitary standards. This is a crucial challenge for smallholders to address if they are to participate meaningfully in the market expansion.
8. The private sector also plays a preponderant role in rural finance, which is recognized as a vital tool in poverty reduction and rural development. Many types of financial intermediaries are active in rural areas, ranging from conventional banking to formal and informal microfinance institutions (MFIs). Public ownership in financial institutions has, in general, been declining as governments have privatized public entities. Also, most of the less-established institutions targeting rural poor people have been created outside the public sector altogether (e.g. either as credit associations or NGOs). At any rate, publicly owned agricultural banks have often suffered from a combination of political interference and poor financial viability, and the trend towards privatization and a reduced governmental role can be expected to continue.

III. IFAD's mandate and target group

9. IFAD's overarching mandate, as set out in its establishment documents, is to mobilize additional resources to be made available on concessional terms for agricultural development in developing Member States. IFAD's target group consists of poor rural women and men (including smallholder farmers, rural wage earners and small-scale entrepreneurs). In its support for private-sector development, IFAD concentrates its efforts on the smaller end of the private-sector continuum. The Fund's activities consist of a combination of technical and financial assistance targeted to smallholder farmers and MSMEs. Concurrently, economic growth and social progress in rural areas is heavily dependent on the vibrancy and performance of the local corporate private sector, with local MSMEs and more established agroprocessors and traders playing an important role in the economic livelihoods of smallholders and the rural poor in general. The establishment of effective linkages with larger private operators is thus critical to achieving sustainable economic and social progress among IFAD's target groups. Failure to achieve such linkages would greatly reduce IFAD's ability to meet its foremost rural poverty reduction objective. Similarly, the establishment of sustainable financial systems serving the rural poor and MSMEs is critical to IFAD's mission. Furthermore, as spelled out in the replenishment paper on country ownership,¹ the active participation of the private sector in countries' development processes strengthens and broadens country ownership of development interventions and increases their sustainability.
10. As expected, however, partnering with the corporate private sector involves both challenges and risks. This sector's main objective is to make profit, sometimes at the expense of small farmers and rural wage earners. Therefore, it is crucial for IFAD to make sure that any partnership with private-sector companies is not exploitative of its target groups and results in sustainable win-win situations. In fact, this is a major role for IFAD in such small farmer-private sector company partnerships. Specific actions are also needed to address gender-based constraints to ensure that women can benefit equitably from new market opportunities. Furthermore, to ensure the sustainability of newly initiated partnerships between the corporate private sector and IFAD's target group, IFAD plays another important role by building poor people's capacity to engage with the corporate private sector in the long run.
11. The Agreement Establishing IFAD confines the bulk of IFAD's financing, mainly concessional loans and grants, to developing Member States or intergovernmental organizations. Through its limited regional and global grant window, IFAD can also provide grants to NGOs, farmers' organizations, and non-profit research organizations or associations, but it cannot provide financing to or engage directly with the corporate private sector. When IFAD was established in 1977, most agricultural services in developing countries were provided by public-sector entities, and the bulk of IFAD funds have since been channelled through central governments or government-controlled entities. The question arises whether such an exclusive approach remains the most effective way for IFAD to achieve sustainable progress among its target beneficiaries. IFAD has much wider possibilities to engage directly with the corporate private sector in the context of financial and administrative operations (e.g. trust funds, administration of accounts on behalf of donors), and it is authorized to undertake these to further its objective. However, while there could be mechanisms and opportunities for IFAD to expand its outreach to the corporate private sector, there are also costs and risks involved in such expansion. These will be spelled out later in the paper.

¹ See IFAD's approach to sustainability (document REPL.VIII/3/R.3).

IV. IFAD's private-sector strategy and current engagement with the private sector

12. Until recent years, IFAD's target groups of smallholder farmers and other rural poor communities were seen mainly as economic agents operating in the context of a largely subsistence model with few linkages to the rest of the economy. Assistance was narrowly focused on increasing crop production, and was provided in the form of public services (e.g. extension services, credit, infrastructure) and capacity-building of the public institutions expected to deliver these services. Recognizing the dramatic changes that have taken place in rural areas, IFAD has since broadened its approach to rural development and developed a specific strategy to underpin its new vision.
13. The Private-Sector Development and Partnership (PSDP) Strategy, approved by the Executive Board in April 2005,² provides the general conceptual framework under which the Fund proposes to engage with the private sector within its current legal set-up. The strategy sets two basic objectives for IFAD: (a) to promote private-sector development in rural areas; and (b) to forge local, national, regional and global partnerships with the corporate private sector that will benefit IFAD's target groups and enable them to overcome poverty. It is organized along three broad lines of action: (i) policy dialogue with governments for local private-sector development; (ii) investment operations to support local private-sector development; and (iii) partnerships with the corporate private sector to leverage additional investments and bring knowledge to rural areas. The strategy thus sees the corporate private sector as a source of both investment and knowledge in rural areas, and as a primary driver of poverty reduction closely linked to IFAD's mandate. With this objective in mind, the strategy underscores the importance of establishing backward and forward linkages between rural producers and surrounding markets. It also points to the need for IFAD to explore new and innovative ways to enhance the impact of its operations by forming partnerships with the corporate private sector. The PSDP strategy is due to be evaluated by IFAD's Office of Evaluation in 2009.
14. Much can and has been done to implement IFAD's PSDP strategy in the context of the Fund's current business model (see appendix, boxes 1-6). A number of interesting initiatives directly involving the private sector have been implemented within sanctioned public-sector projects, including several cases where part of a government programme was allocated to a privately managed initiative involving contract farming or market linkages (boxes 1 and 2). IFAD's rural finance operations have also increasingly involved privately owned financial institutions (box 3). Refinancing facilities designed to encourage private commercial banks to step up lending in rural areas have been particularly successful (box 4). These initiatives have been received positively by both the governments involved and the affected communities. Through its limited regional and global grant window, IFAD has also been able to extend some resources to support pro-poor private-sector business development, as, for example, in the case of PhytoTrade, a member-based trade association (box 5), or to contribute to development funds geared to private enterprises such as the Africa Enterprise Challenge Fund (box 6). IFAD could probably do much more if it could engage the private sector on the basis of a broader and more flexible set of business models and financial instruments. There are risks and costs involved in such an expanded engagement, so several avenues need to be explored, one of which being to continue operating under the existing PSDP strategy. More ambitious proposals are also presented for discussion in the remainder of the paper.

² Document EB 2005/84/R.4/Rev.1.

V. The approach of other development organizations

15. Like IFAD, most international financial institutions (IFIs), whether multilateral or bilateral, were initially established with a clear public-sector focus. These institutions, however, gradually recognized the changing economic environment in which they operated, in particular the growing role of the private sector and its interaction with their own developmental and poverty reduction mandate. Seeing private-sector development as the prime engine for poverty-reducing economic growth, they concluded that developing an operational capability to deal directly with the private sector was critical if they were to remain relevant. In some cases, separate entities were created, operating in parallel with the original institutions to provide dedicated support to the corporate private sector in developing countries. This includes, inter alia, the International Finance Corporation (IFC), the Inter-American Investment Corporation and a number of bilateral agencies (e.g. the German Investment and Development Company, Promotion et Participation pour la Coopération économique [PROPARCO] of France, the Capital for Development Group of the United Kingdom, Swedfund of Sweden). In other cases, the rules of engagement of the original institution were modified post-establishment to accommodate private-sector operations through specially designed windows (e.g. the African Development Bank, Asian Development Bank, Inter-American Development Bank, Agence Française de Développement). Finally, the European Bank for Reconstruction and Development was established to deal with beneficiaries in both the public and private sectors.
16. By and large, the private-sector activities of these IFIs have been focused on capital-intensive sectors with large funding requirements, such as infrastructure. Their ability to address the needs of IFAD's target groups has remained limited because of scale and risk considerations. This leaves a significant niche of unmet assistance needs for IFAD to address. It also presents IFAD with opportunities to form partnerships with these agencies on a broader basis and to stimulate a stronger focus on rural areas within the IFI community.
17. **World Bank group.** The International Bank for Reconstruction and Development, and the International Development Association, which it manages, continue to deal exclusively with sovereign borrowers, focusing their attention in the area of private-sector development on strengthening the enabling environment for private investment and supporting the growth of domestic capital markets for financing small and medium enterprises. The World Bank group also includes two separate entities specifically designed to address the financial needs of the private sector in developing countries: the IFC and the Multilateral Investment Guarantee Agency (MIGA). IFC, which was established in 1956, acts as the private-sector arm of the World Bank group. It promotes sustainable private-sector development, encouraging the growth of productive enterprises and efficient capital markets through a combination of loan and equity investments and technical assistance. IFC forms partnerships with a broad range of third parties, including foundations and charitable organizations, connecting them with businesses to fill critical gaps in such areas as environmental sustainability, health, education and rural development. MIGA offers guarantee products to facilitate private investment in developing countries.
18. **The European Bank for Reconstruction and Development (EBRD)** was established in 1991 to help build open-market economies and promote private and entrepreneurial initiative in Central and Eastern European countries (countries in Central Asia were added subsequently). To this end, EBRD invests (in loan and equity) mostly in private enterprises even though its original mandate gives it the flexibility to deal with both sovereign and non-sovereign clients. It also works with publicly owned companies (often without the benefit of a sovereign guarantee) with a view to supporting their privatization or improving municipal services.

19. **The Agence Française de Développement (AFD)**, the development aid agency of the French Government, functioned initially as a purely public-sector financing organization. In recent years, it has developed a broad range of financial tools that enable it to support both public- and private-sector projects. Its operations include grants, guarantees, sovereign and non-sovereign loans, and equity investments (made either directly or through investment funds). In assessing the risk profile of private-sector projects, AFD relies in part on the expertise of its subsidiary, PROPARCO, which was partially privatized and is fully dedicated to private-sector financing.
20. **The African Development Bank (AfDB)** has set private-sector development as a strategic objective for its operations in Africa. To achieve this objective, it supports policy reform in its regional member countries, improving their physical and financial infrastructure, facilitating know-how and technology transfer, and making or catalysing direct investments in private enterprises. Direct investment (loan and equity) operations not benefiting from a sovereign guarantee are handled by AfDB's private-sector window, established within its Private-sector Department in 1991, which also handles technical assistance operations aimed at the private sector. Areas of focus for AfDB's private-sector activities include infrastructure-related projects (especially those involving public-private partnerships) and transactions with financial intermediaries where it combines direct financial support with technical assistance to strengthen the managerial capacity of local financial institutions.
21. **The Asian Development Bank (AsDB)** provides direct assistance to private-sector projects in Asia through its Private Sector Operations Department (PSOD). PSOD's operations are focused primarily on capital markets and the financial and infrastructure sectors. PSOD also invests in other economic sectors through investment funds targeting small and medium enterprises.
22. **The Inter-American Development Bank's (IDB)** mode of engagement was progressively broadened to accommodate non-sovereign (including private-sector) operations. IDB currently supports private-sector development in Latin America through three separate windows: its own Structured and Corporate Financing Department established in 1994, the Inter-American Investment Corporation (IIC) and the Multilateral Investment Fund (MIF). IDB's own private-sector investments are focused on capital-intensive enterprises operating in the infrastructure and energy sectors. IIC is an independent multilateral organization affiliated with IDB, whose purpose is to foster the development of small and medium enterprises as a means of furthering sustainable economic development. MIF uses technical cooperation grants to support improvements in the business environment and promote sustainable private-sector growth.

VI. Future IFAD work with the private sector

23. The implementation of the Fund's PSDP strategy within the context of government programmes has led to some interesting initiatives, especially in countries where governments have been willing to use IFAD loan proceeds to engage with the local corporate private sector.
24. Overall, however, IFAD is restricted under its existing business model in its ability to engage commercial private entities in the design and implementation of its projects. While central government programmes provide opportunities to engage with the corporate private sector, and such opportunities should be more systematically identified and pursued, IFAD's instruments are not sufficient for the Fund to address the broad needs of the rural poor in association with the corporate private sector. To expand its role to include the corporate private sector as other IFIs have done, IFAD needs new instruments enabling it to deal directly with private companies and enterprises and with local non-governmental civil society representatives, rather than exclusively going through government. Engaging the private sector directly all along the value chain would offer IFAD additional means to deliver sustainable

development results for the smaller end of the rural economy by leveraging its own funds. Helping channel private-sector remittances towards rural development (encouraged, for example, by IFAD cofinancing or by matching grants) would also be another opportunity for IFAD to bring private-sector resources to rural areas. Private enterprises would be seen not only as interested parties, but also as potential partners and cofinanciers for IFAD's programmes. A variety of possible channels exist for engaging directly with the private sector, each with challenges and opportunities. These are discussed in the next section.

Market linkage programmes

25. A combination of financial and non-financial assistance is often required to enable smallholder farmers to upgrade their farm management practices and enhance quality and sanitary standards to the point where they can meaningfully integrate into the commercial economy. Effective arrangements to deliver such market linkage programmes can best be organized locally and may need to involve a multiplicity of players. These could include the farmers themselves (individually or as an association); agroprocessors and traders as potential market outlets, which could become involved in the design, cofinancing and/or implementation of the package; local NGOs as service providers; and rural banks or MFIs to provide financial services to farmers. These efforts need to address gender roles throughout the value chain to ensure equitable opportunities for women. Key objectives of market linkage programmes include (a) disseminating best farming practices to increase productivity and mitigate the environmental footprint of agriculture (addressing growing concerns about the scarcity of land and water); (b) creating value throughout the supply chain and access to markets to the benefit of farmers (e.g. by introducing new seed varieties better adapted to market requirements); (c) meeting traceability requirements in the food chain; and (d) promoting fair labour practices, including equitable opportunities for women. Private traders and agroprocessors may also act as conduits to transfer funds to farmers (in the form of advances against future agricultural production in the context of contract farming arrangements). Working on farm financing or contract farming schemes through established enterprises would enable IFAD to increase local farmers' access to necessary inputs and financing.

Assistance to micro, small and medium enterprises

26. To a large extent, reduction of rural poverty is linked to the ability of poor people to diversify their sources of income through off-farm employment. MSMEs are thus called to play a central role in any long-term poverty reduction strategy. The development of rural enterprises faces a number of financial and non-financial constraints, including lack of access to financial services, insufficient managerial skills and poor capitalization. To address these issues effectively, IFAD requires a combination of instruments that are difficult to assemble under its current operational set-up. As discussed further below, the promotion of financial services in rural areas often requires involving private banks, an approach that IFAD cannot easily adopt. Similarly, developing a sustainable business advisory capacity aimed at strengthening managerial skills in rural communities while addressing the lack of equity capital in MSMEs (e.g. by participating in small and medium enterprise-focused investment funds that balance financial and developmental objectives) are challenges requiring new operational instruments for IFAD.

Rural finance

27. While access to efficient financial markets is a crucial condition for economic development, this condition largely remains unmet in the rural areas of developing countries. IFAD's institutional objective of promoting the emergence and sustainable development of financial institutions that can serve the rural poor is thus central to its mission. To meet its ultimate developmental objective, IFAD has to be more proactive in promoting the institutional development and sustainability of rural financial service providers. Commercial banks are often reluctant to finance MSMEs,

and may need support and incentives to adapt their products and internal systems to respond to the specific profile of rural customers. Less established institutions, including microcredit providers, also require a combination of financial support and technical assistance to strengthen their managerial capacities (portfolio management, risk management, staff capacity-building), which would be best provided through IFAD's direct engagement.

28. Rural financial institutions may also need additional capital, which IFAD could help obtain through equity or quasi-equity investments (e.g. to help meet legal minimum capital requirements when transforming non-formal institutions into formal ones). In many regions, the supervision of MFIs is made difficult by the absence of an efficient regulatory framework, making direct investment problematic. To circumvent these constraints, IFAD could consider joining other development agencies that have pooled their resources in support of private apex vehicles to deal with MFIs on a country or regional basis. A broader array of financial instruments would thus provide IFAD with much needed flexibility in addressing both financial and institutional constraints in the rural finance sector.

Raising funds from innovative sources

29. Contrary to most other IFIs, IFAD has so far relied exclusively on periodic capital replenishments (together with reflows and interest payments) to fund its operations. Yet, there is ample evidence that significant amounts of resources, both within government bodies and the private sector, are available for well-structured aid programmes designed to address critical developmental issues. Taking note of this situation, a number of IFIs have endeavoured to raise financing from innovative sources through outreach programmes aimed at non-traditional donors, including private enterprises, individuals and foundations. Given the specificity of its mandate, one option is for IFAD to emulate these efforts and develop a similar collaborative programme. The Fund is particularly well placed to establish itself as a key partner for donors wishing to focus their attention on such issues of current interest as agriculture, rural poverty, land and water use, and climate change.
30. A number of donors have already approached IFAD with specific proposals, including several Member State governments and private foundations (e.g. the Bill & Melinda Gates Foundation). IFAD proposes to pursue and develop two or three long-term partnerships with outside parties during the next replenishment period. The aim would be to leverage its own resources and bring added benefits to developing countries while, in the case of private partners, benefiting from a private-sector perspective and know-how in addressing development issues. It is likely, however, that non-traditional sources would be more accessible to IFAD if funding requests were made in the context of programmatic partnerships organized around innovative approaches to rural development. Broadening IFAD's sources of funding to leverage its regular capital replenishments is thus closely linked to its ability to deploy new instruments and financing mechanisms.

IFAD's comparative advantage and proposed future role

31. IFAD's comparative advantages in addressing the critical interface between rural poverty and private-sector development include: (a) its intimate knowledge of the developmental challenges faced by its target population, including gender-based challenges; and (b) familiarity with the rural areas where many of these target groups are located.
32. Thus for IFAD, the basic objective of transactions involving the corporate private sector is to mobilize market forces for poor rural women and men. In pursuit of this objective, IFAD can engage more systematically with the corporate private sector in the design, financing and implementation of its projects. Yet to achieve the objective, IFAD also needs financial instruments enabling it to transact directly with private companies and entities in the context of projects that have a broad development rationale in line with its mandate. This includes direct loan, equity or

quasi-equity investments in private enterprises (including farmer associations), investment funds and financial intermediaries as a complement to its traditional sovereign investment activities. It also includes the use of grant funds in schemes involving private enterprises (e.g. through grant matching) or NGOs (as implementing agencies).

33. In managing such transactions, IFAD would set for itself two basic objectives: (a) to extend financing (directly or through intermediaries) to the smaller end of the rural enterprise universe to stimulate its development; and (b) to develop partnerships with larger market players in order to promote the economic prospects of smallholder farmers in their areas of operation.
34. Typical operations would be designed:
 - (i) To address the financial and technical assistance needs of farmer communities by involving local agroprocessors and traders in the design, funding and implementation of programmes designed to establish or strengthen market linkages. Direct investments with farmer associations and cooperatives would be considered. Cofinancing opportunities with corporate private partners would be actively sought. Direct lending to private companies and enterprises would be occasional and normally intended for the specific purpose of supporting groups of farmers of interest to IFAD;
 - (ii) To support medium-sized rural enterprises (e.g. agroprocessors, input suppliers) lacking access to adequate financing. Opportunities for IFAD to participate in venture capital funds targeting rural companies and enterprises in specific countries or regions would be investigated; and
 - (iii) To broaden IFAD's approach to rural finance by dealing directly with financial institutions providing financial services to MSMEs or small farmers. Investments in financial institutions (directly or through an apex structure) would prompt IFAD to focus more consistently on the crucial issue of financial sustainability. It would also stimulate the use of IFAD resources for quasi-equity (or equity) investments so as to strengthen the financial structure of institutions particularly relevant to its mission.
35. Financial considerations aside, IFAD would face the potential risk that its development objectives, and targeting policy, may not be adequately met in working with the corporate private sector in the context of agricultural value chains. This risk would have to be carefully managed. But it is also the case that market-based operations would give IFAD the opportunity to address, and help correct, the inherent bias of market forces favouring large producers. They would also enable IFAD to promote the dissemination of fair labour and sound environmental practices in contract farming, while identifying specific opportunities for women and other disadvantaged population groups. Monitoring the development impact of operations, based on specific, measurable performance indicators, would be an important element of IFAD's engagement with the corporate private sector.
36. IFAD's ultimate objective is to optimize the impact of its operations while seeking to leverage its scarce resources – which are likely to remain limited when set against the enormous funding needs of the rural poor. The types of projects and programmes that generate the greatest long-term benefits to smallholders have changed with the business environment prevailing in rural areas. Engaging with the private sector offers IFAD much opportunity for progress, with the prospect of greater effectiveness in addressing the developmental needs of its target beneficiaries. This may entail funding higher-risk operations with a broader developmental impact, preferably on a risk-sharing basis. But there are also serious risks associated with a "business as usual" approach – notably the risk that IFAD's relevance to the sustainable development of rural areas declines over time.

37. IFAD's ability to coordinate its activities with larger private-sector players and take advantage of the new market dynamics will depend on the buoyancy and diversity of agricultural value chains, the financial services sector and the rural economy as a whole, in each particular country. The objective is for IFAD to develop synergies wherever possible and maximize the multiplier effects of its scarce concessional financing. In that context, the private sector has for IFAD the potential of becoming (a) a partner in the design, financing and implementation of its operations; (b) the recipient of a direct investment where this can contribute to IFAD's poverty reduction objectives; and (c) an additional source of funding for IFAD on a programmatic basis.
38. In summary, to respond to the emerging role of the private sector in developing countries' rural economies, and after having taken into consideration the results of the evaluation of its PSDP strategy (due in 2009), IFAD proposes to pursue the key actions set out in the following section.

VII. The way forward: key actions

39. First, IFAD will continue to work within the existing framework of the PSDP strategy to do more of the types of operations presented above (see examples in the appendix). The focus will be on helping build the conditions for successful partnerships between smallholder farmers and larger private-sector operators or private companies within the regular IFAD lending programme, looking at both the conditions that support the investment of private-sector capital itself and ensuring that the partnership is beneficial to both sides. As spelled out in the PSDP strategy, IFAD will also seek to leverage existing private-sector resources/mechanisms for rural poverty reduction. The grants programme will also be increasingly used to support innovative institutional arrangements to promote partnerships with the private sector; this will be reflected in the revised grants policy to be presented to the Executive Board in December 2009.
40. Second, IFAD will also explore with potential partners, taking into account the institutions and facilities that already exist, the need for a new facility to promote private-sector investment in rural areas. If such a need is identified, then a detailed proposal will be prepared and presented for approval to IFAD's Executive Board by December 2009. The facility would have two broad purposes: to provide investment finance directed to the private sector; and to provide policy and institutional support to help establish the enabling environment for private-sector development. The facility would be financed with resources mobilized from sovereign investment funds, grants from multilateral and bilateral donors, and contributions from non-governmental sources (including foundations and private donors).
41. Third, IFAD will assess the need, value added and feasibility of developing new instruments to engage directly with the private sector, including through non-sovereign lending and equity investments. To this end, and taking account of the experience in exploring the above facility, IFAD will present to the Executive Board, by December 2011, a review analysing the experience of other international development agencies that have broadened the scope of their operations and instruments to engage directly with the private sector. Such instruments can provide flexibility to deal directly with a broader range of partners in the public and private sectors. This is the approach adopted when, for example, EBRD was created and, more recently, by several regional development banks and AFD. It is recognized, however, that developing such instruments would have significant implications for the Fund's current structure, financial risk management and institutional and staff capacity development.³ The approval of the relevant governing bodies would also be required..

³ Staff training, possibly in the form of exchange programmes or staff secondment with other IFIs that have private-sector experience (AFD, for example), would be an important ingredient.

<p>Box 1 – Madagascar - linking rural producers to export markets</p> <p>The Rural Income Promotion Programme is helping small-scale agricultural producers in north-east Madagascar to commercialize new products by creating sustainable linkages with buyers. It does so by creating “partnership poles” that bring together local authorities, local producers, exporters and microfinance institutions. Whereas producers used to be overly dependent on intermediaries and there was little confidence among partners, the poles allow partners to negotiate contracts on equitable terms. Within each pole, producer organizations are grouped into an agricultural cooperative operating as a Market Access Centre and responsible for managing a collection and storage space for the products. The cooperatives help producers to find the best commercial outlets, meet exporters’ standards, and build lasting partnerships with commercial operators. Typical products for export include cloves, lychees, honey and chilli peppers. Most of these products are now exported to Europe, Asia and the United States, earning local producers significantly higher prices than they would fetch on the domestic market. The programme was initiated in 2004 and is expected to run for eight years. To date, seven partnership poles have been initiated, with a further ten to be established in the near future.</p>	<p>Box 2 - Rwanda - Smallholder Cash and Export Crops Development Project</p> <p>The project, which provided for the development of new tea plantations, anticipated the construction of a tea processing factory by a private investor. When this failed to materialize, an alternative was developed in the form of a joint-venture company involving a new private investor, the government and farmer cooperatives. The new company, the Nshili Tea Company, established a processing plant close to the plantation. This solution has proved beneficial to all players. Small producers sell tea from their own plots to the company while also working on other estates owned by the private investor. They collectively own a 15 per cent share in the company and sit as members on the board of directors of the company. The investor holds a 70 per cent share in the company and brought the long-term financial resources required for the construction of the processing plant. The investor has helped build the capacity of smallholders to deliver a quality product, training them in collection and cutting techniques, and helping ensure compliance with international standards.</p> <p>Rwandan tea leaves are of excellent quality. The development and promotion of tea offers good potential for economic growth in the country, and an opportunity to increase incomes for poor rural households. The project continues to build the capacity of the cooperatives to influence prices, deal with exporters, and learn management techniques. Meanwhile another tea estate was developed in Mushubi with a view to replicating a similar partnership.</p>
<p>Box 3: Equity Bank Kenya – providing credit across the value chain</p> <p>Part of IFAD’s Smallholder Horticulture Marketing Programme in Kenya is used to support the National Accelerated Agricultural Inputs Access Programme (NAAIAP) established as a partnership with the Ministry of Agriculture and the Alliance for a Green Revolution in Africa (AGRA). IFAD and AGRA have each contributed US\$2.5 million to the programme. The NAAIAP which is managed by the Equity Bank in Kenya (a private bank) is intended to help small-scale horticulture farmers and others involved along the value chain to improve productivity and build viable businesses. The Programme enables the Equity Bank to improve the terms of financial services offered to agricultural sector players (from input supply to marketing), e.g. by establishing a guarantee fund and dropping interest rates from about 15 per cent to 12 per cent. Other partners are expected to join the programme as its scope expands.</p>	<p>Box 4: Refinancing attracts private banks to the rural areas in transition economies</p> <p>Starting in 2000, IFAD introduced refinancing facilities as part of its rural finance programmes in Moldova, Macedonia and Armenia to spur (private) commercial bank lending in rural areas. A Refinancing Unit was established in each country, typically under the Ministry of Finance, to manage the scheme. Upon receiving a loan request from a rural client, each eligible financial institution could then seek refinancing from the Unit as a funding source for the transaction. These refinancing facilities provided much needed capital for rural investment in the three countries, encouraging financing institutions to expand their commitment to rural finance. Such refinancing facilities being fully funded by IFAD do not put any burden on state budgets, but remain dependent upon the governments’ willingness to pass on part of the proceeds of an IFAD loan to private financial institutions rather than to public-sector entities. Despite the positive results, replication elsewhere has as a result been limited.</p>

Box 5: PhytoTrade Africa - commercializing natural products to benefit IFAD’s target group

PhytoTrade Africa is a member-based trade association generating additional incomes for small-scale rural communities in Southern Africa through market mechanisms. It was established to help create a network of sustainable and equitable processing industries making use of natural resources accessible to poor rural communities. PhytoTrade links and coordinates agroprocessors in several countries across the region, investing in product research and development, engaging export buyers, and developing and sustaining long-term business partnerships. It helps its private sector member companies build their capacity to develop niche products made from local resources, and trade on European export markets. These companies buy raw material harvested from the wild from rural suppliers, which is then processed into natural oils, health care products, herbal teas, jams, and nutritional supplements. In 2007 nearly 15,500 primary producers sold more than 80 tons of raw or semi-processed natural products to PhytoTrade members. A total of 50 new products have been developed, many of which have received organic and Fairtrade certification.

Box 6: African Enterprise Challenge Fund - leveraging investments from the private sector

In 2008, with a small regional grant of US\$200,000, IFAD became one of six donors contributing to the African Enterprise Challenge Fund. The Fund, worth a total of US\$50 million, offers matching grants to small and medium businesses across the African continent with demonstrable benefits to poorer rural people and the rural economy.

The African Enterprise Challenge Fund is hosted by the Alliance for a Green Revolution in Africa, while its daily operations are overseen by the management consultancy firm KPMG. The recently-launched fund has received over two hundred applications in the first round of its grant disbursement but is also proactive in scouting for potential entrepreneurs. Successful recipients will be private sector entrepreneurs who have found profitable ways of improving market access and functioning for the poor, especially in rural areas.

