

**PRIVATE SECTOR** | **POLICY**  
DEVELOPMENT AND PARTNERSHIP  
STRATEGY



Enabling the rural poor to overcome poverty



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# ABBREVIATIONS AND ACRONYMS

IFI	international financial institution
PBAS	performance-based allocation system
PSDP	private-sector development and partnership
RFI	rural financial institution
SME	small and medium enterprise
RIMS	results and impact management system
IMI	initiative for mainstreaming innovation

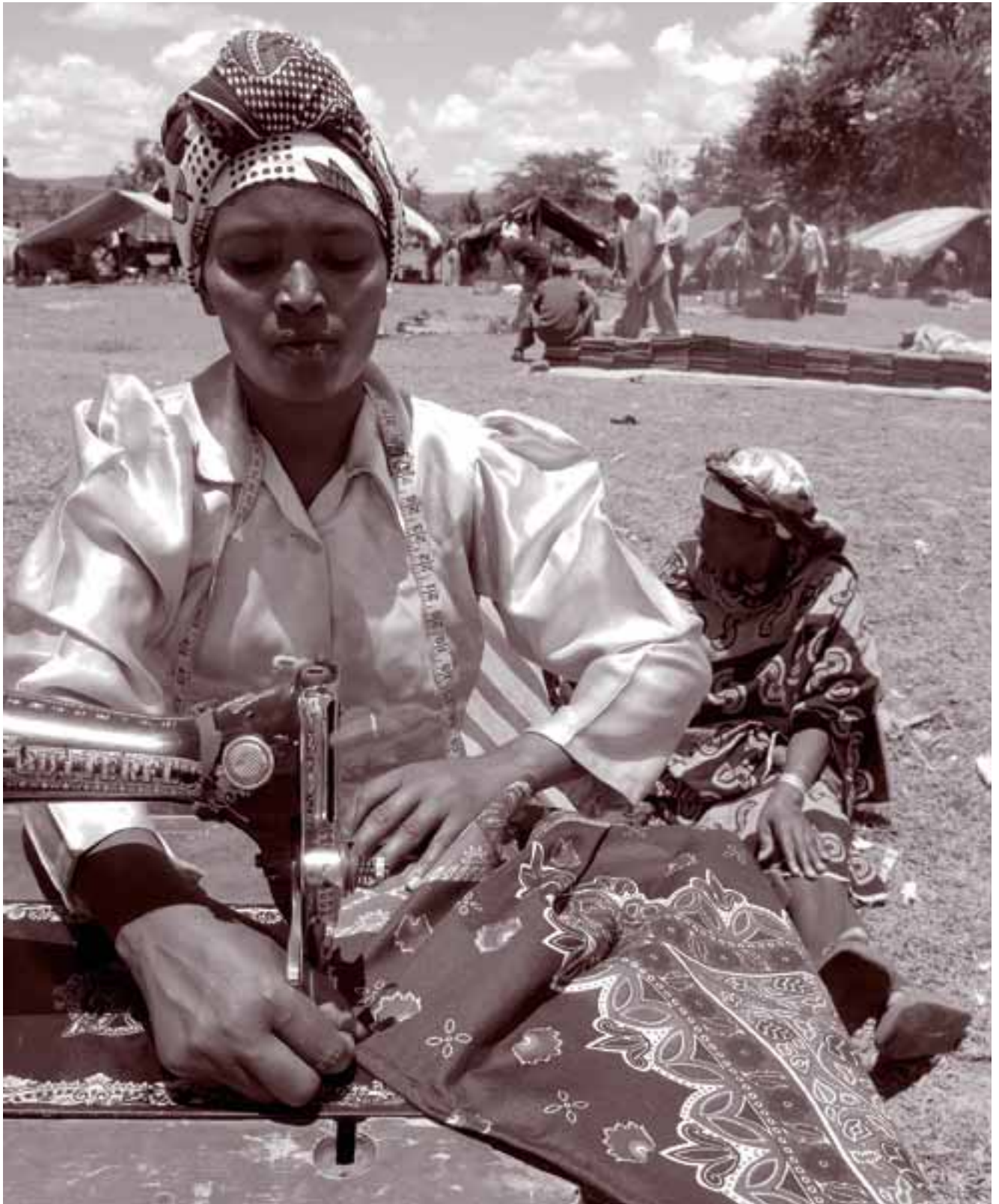
## Summary

The economic environment in which rural poor people seek to earn a living has changed dramatically over the past 20 years. In most developing countries, the private sector is now responsible for the majority of employment and income-generating opportunities, and has become the driving force for poverty reduction. Poor rural producers represent a large part of the private sector in developing countries. Rural poor people also interact with other private operators on a daily basis.

This paper presents IFAD's strategy on how best to promote private-sector development in rural areas. The paper also looks at how IFAD can forge local, national, regional and global partnerships with the private sector that will benefit IFAD's target groups and enable them to overcome poverty.

The strategy is organized along three broad lines of action:

- policy dialogue for local private-sector development;
- investment operations to support local private-sector development; and
- partnership with the private sector to leverage additional investments and bring knowledge to rural areas.







# 1

## INTRODUCTION



Over the past ten to 20 years, the economic environment within which the rural poor seek their livelihood has changed substantially in many developing countries. In Africa, governments that used to play a key role in the organization of economic relations have now largely withdrawn from productive activities. Similarly, in the transitional economies of Central and Eastern Europe, governments have changed the nature of their role in rural areas, following the collapse of the Soviet Union and the dismantlement of command economies. These once dominant actors in production and marketing are now largely seeking to promote private-sector investment. In Asia, subsistence farmers are increasingly able to produce a marketable surplus, and the barter economy is giving way to a much higher level of monetization. And while state-owned organizations are still active in some developing Asian countries, their contribution to rural economic growth has diminished considerably. Equally, government services are being subjected to new market forces and competition from the private sector. In Latin America as well, economic reforms over the last two decades have meant that productive economic activities – including the provision of rural services, once dominated by state organizations – have been opened up to the market.

Other important trends, such as globalization and the pursuant growing integration of local,

national and international economies; high rates of youth unemployment due to a current demographic bulge in the number of young people;<sup>1</sup> the expanding roles of remittances and microfinance in generating income; the changing market structure of agri-food chains and the rapid expansion of supermarkets (especially in Latin America – see Box 1 below); and the revolution in information and communication technology have all contributed to the dramatic change in the rural economies of the developing world.

In this new and dynamic global environment, the role of the private sector is becoming ever more important. The private sector provides most income-generating activities and job-creation opportunities, and is increasingly becoming the driving force for economic growth and poverty reduction.<sup>2</sup> IFAD's target groups (i.e. small farmers, herders, woman-headed households, rural wage-earners, rural microentrepreneurs and small agricultural traders) represent a large part of the private sector in developing countries; and rural poor people interact on a daily basis with other private operators in order to access resources, buy inputs, use technology, receive services, obtain credit, or sell their services and products.

Rural market economies are fuelled by the economic relationships that exist among small rural producers and with other actors in private-sector markets. Most of those markets

<sup>1</sup> In some developing countries, especially in Africa and the Near East, it is estimated that about 50 per cent of the population is less than 20 years old.

<sup>2</sup> Domestic private investment averaged 10-12 per cent of gross domestic product in the 1990s, compared with 7 per cent for domestic public investment and 2-5 per cent for foreign direct investment according to the report *Unleashing Entrepreneurship: Making Business Work for the Poor*. Published by the United Nations Development Programme, the report was prepared by the Commission on the Private Sector and Development, and presented to the Secretary-General of the United Nations in 2004.

## BOX 1

### The rising importance of supermarkets in Latin America

The rapid expansion of supermarkets in Latin America has resulted in a revolutionary change in the structure of the region's agri-food industry. Supermarket chains now control about 60 per cent of the retail food market in Latin America, up from 10-20 per cent in 1990. Supermarkets sell two to three times more fresh fruits and vegetables than the total amount exported by Latin America. There is also a high degree of market concentration: just five multinational supermarkets control two thirds or more of the food retail market in countries as diverse as Argentina, El Salvador, Honduras and Mexico. This market power has allowed them

are evolving rapidly, and although in certain areas they are extremely vibrant, in others – often those of most importance for poor people – they remain weak and underdeveloped. Yet even where those markets do work, the rural poor, because of the many constraints they face (material, institutional and policy-based), are not always able to capture the opportunities available in this new environment. As a result, the general move towards economies in which market forces and the private sector play a central role does not always reflect the interests of the rural poor. IFAD has an essential part to play in equipping the rural poor to interact more equitably with new market forces and in making market relationships work for them.

In September 2004, a comprehensive document representing IFAD's strategy for private-sector development and partnership was submitted to the Executive Board. The Board approved the principles underlying IFAD's strategy, but requested a simplified and more operational document with a results framework, to be resubmitted to the eighty-fourth session of the Executive Board in April 2005. This paper embodies this revised document. Its main objective is to present IFAD's operational strategy on how to promote the development of and partnership with the private sector – locally, nationally, regionally and globally – in order to benefit the rural poor.<sup>3</sup> It defines the specific objectives, outputs

and types of activities that IFAD will pursue in order to engage the private sector in reducing rural poverty, and uses a results-based approach to measure achievements and monitor progress. It also lays out what will change, or would need to be changed, in IFAD in order to implement the strategy.



<sup>3</sup> The Consultation on the Sixth Replenishment of IFAD's Resources, whose final report was approved by the Governing Council in 2003, focused on the issue of working in partnership with others as a strategy to enable IFAD to be more effective in implementing its strategic framework, ensuring programme impact and fulfilling its catalytic role. It elaborated on the importance of partnering with the private sector (among others), and specifically requested IFAD management to provide the Executive Board with a "strategy for achieving greater involvement of private-sector participants in IFAD programmes, through cofinancing and other forms of partnership consistent with IFAD's mission".

to impose their own private grades and standards on major food products, which in turn have a significant impact on technological, organizational, managerial and financial aspects of the related food production and marketing chain, changing the old ways in which food is grown, processed, traded, sold and bought. The high transaction costs of dealing with numerous small farmers, added to the fact that small farmers often cannot meet the required standards, mean that supermarkets frequently prefer to work with a few large-scale farmers who are better able to deliver the quantity and quality standards set by the company. There is thus a growing threat that, unless their capacity to comply with new procurement and quality standards is improved, small farmers will be driven out of major food markets in Latin America.



# 2

## DEFINING THE PRIVATE SECTOR

In order to have a focused and IFAD-specific private-sector development and partnership strategy, it is important to have a clear understanding of what constitutes the private sector in rural areas. The rural private sector includes a whole continuum of economic agents, ranging from subsistence or smallholder farmers, rural wage-earners, livestock herders, small-scale traders and microentrepreneurs; to medium-sized, local private operators such as input suppliers, microfinance institutions, transporters, agro-processors, commodity brokers and traders; to other, bigger market players that may or may not reside in rural areas, including local or international commodity buyers and sellers, multinational seed or fertilizer companies, commercial banks, agribusiness firms and supermarkets. Associations of farmers, herders, water users or traders also constitute an important part of the private sector.

IFAD's direct target group is the rural poor, who tend to be concentrated at the smaller end of the private-sector continuum. This group is considered part of the private sector because, in essence, it comprises agro- or rural-based microentrepreneurs who make their own economic decisions regarding what to produce and how to produce it, what to buy and sell, who to buy from and sell to, how much to buy or sell, and when. IFAD will concentrate its efforts on supporting the development of this private-sector target group. However, since the livelihoods of IFAD's target group are often dependent on other private-sector operators, IFAD will also support or partner with those private-sector operators that can provide improved income-generating opportunities for IFAD's target group.

The types of private-sector operators that exist, and their relative size and degree of development, vary of course from region to region and country to country. While in some regions (e.g. in Asia), private microfinance institutions are more developed and function relatively better, in others (e.g. in the Near East and North Africa region) there is a dire need to develop private financial service providers that can serve the rural poor. Similarly, some regions have a much more vibrant and developed agribusiness sector, while in others (e.g. in Africa), this subsector is a limiting factor in the development of markets for smallholder agriculture. For this reason, IFAD will work in different ways with different types of private-sector actors, depending on their importance for the rural poor in the various regions. IFAD will also promote relationships among the various private-sector actors, because mutually reinforcing commercial relationships are the only ones that are viable and sustainable in the long run. In order to support these relationships and the groups behind them, it is important to identify the constraints facing each group and their financial interests, as well as means to address those constraints.









# 3

CONSTRAINTS THE PRIVATE SECTOR  
FACES IN RURAL ECONOMIES

In rural economies, different private agents face different types of economic constraints that limit their potential for growth. Some of these constraints are intrinsic and include lack of access to knowledge and skills, while others are due to the external environment in which they operate (for example, an inappropriate policy and institutional framework, or inadequate rural transport infrastructure). In either case, the constraints are such that rural economies are often perceived by many private-sector players as too costly and risky an option for investment.

Typically, small farmers (to varying degrees and depending on the country) face constraints such as lack of technical, business or marketing skills; poor access to technology, financial services, and social and physical infrastructure (e.g. schools, training centres, health clinics, roads and markets); and low capacity to influence government policies. As a result, they are often unable to increase their productivity or produce a market surplus with which they can improve their cash income. Or if they are able to produce a surplus, they often lack the necessary information or skills to market it effectively and profitably.

While the number of workers in agriculture, including the self-employed, has stagnated in large parts of the world, the number of rural residents becoming non-farm rural employees continues to increase.<sup>4</sup> Non-farm rural employment and self-employment are of particular significance to rural women and youth. However, potential employers such as agro-processors or other rural entrepreneurs

may find it difficult to open a business or expand their operations because they cannot obtain credit or do not have access to non-financial business services.<sup>5</sup> As a result, further job opportunities for unemployed rural women and youth are not available. This exacerbates rural-urban migration and the loss of productive segments of the population in rural areas.

At the same time, private traders or service providers may lack the business or financial skills to make their businesses profitable. According to the report *Unleashing Entrepreneurship: Making Business Work for the Poor*, there are three main constraints on entrepreneurship and private-sector growth in developing countries: lack of access to finance; lack of access to skills and knowledge; and lack of a level playing field for firms competing in the domestic market.

Agribusiness companies, too, may have an inadequate understanding of the rural population as a market for their services or as potential suppliers of produce. Where they do have rural clients, they may face high transaction costs. These include not only those costs associated with large numbers of dispersed small producers, but also those derived from a poor institutional, regulatory and policy environment. For example, legislation on market conduct is often lacking, contracts are not enforced, and information about the trustworthiness of small clients is not available. This means that investing in rural areas, and in particular contracting with small farmers or other rural dwellers, is often seen as too risky.

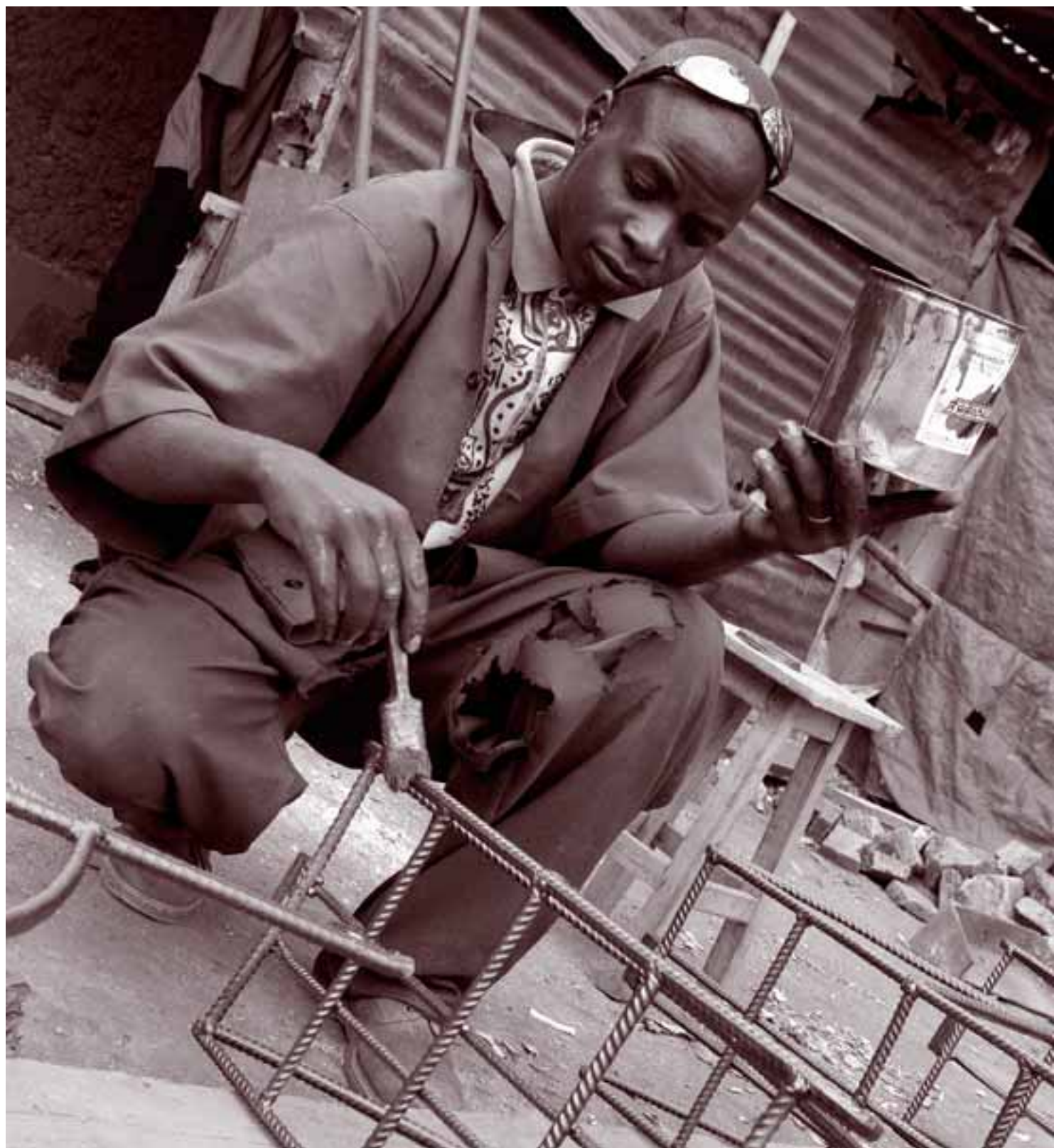
<sup>4</sup> In Latin America, for example, it is estimated that about half of the total income of rural households is derived from non-agricultural employment. Similarly, the non-farm economy in Asia contributes 20-50 per cent of total rural employment.

<sup>5</sup> See IFAD *Rural Enterprise Policy*.

What is therefore needed in order to stimulate private-sector-based rural economies to the benefit of the poor is not only a lessening of the obstacles that each group faces on its own terms, but the creation of conditions that can facilitate fair market relations among the various players. In partnership with the public sector, other donors, non-governmental organizations (NGOs) and relevant private organizations, there is an important role for IFAD to play in helping both the rural poor and other private operators overcome the various market constraints, and in making their market-based relationships more profitable and appealing, resulting in win-win situations for both groups.

3

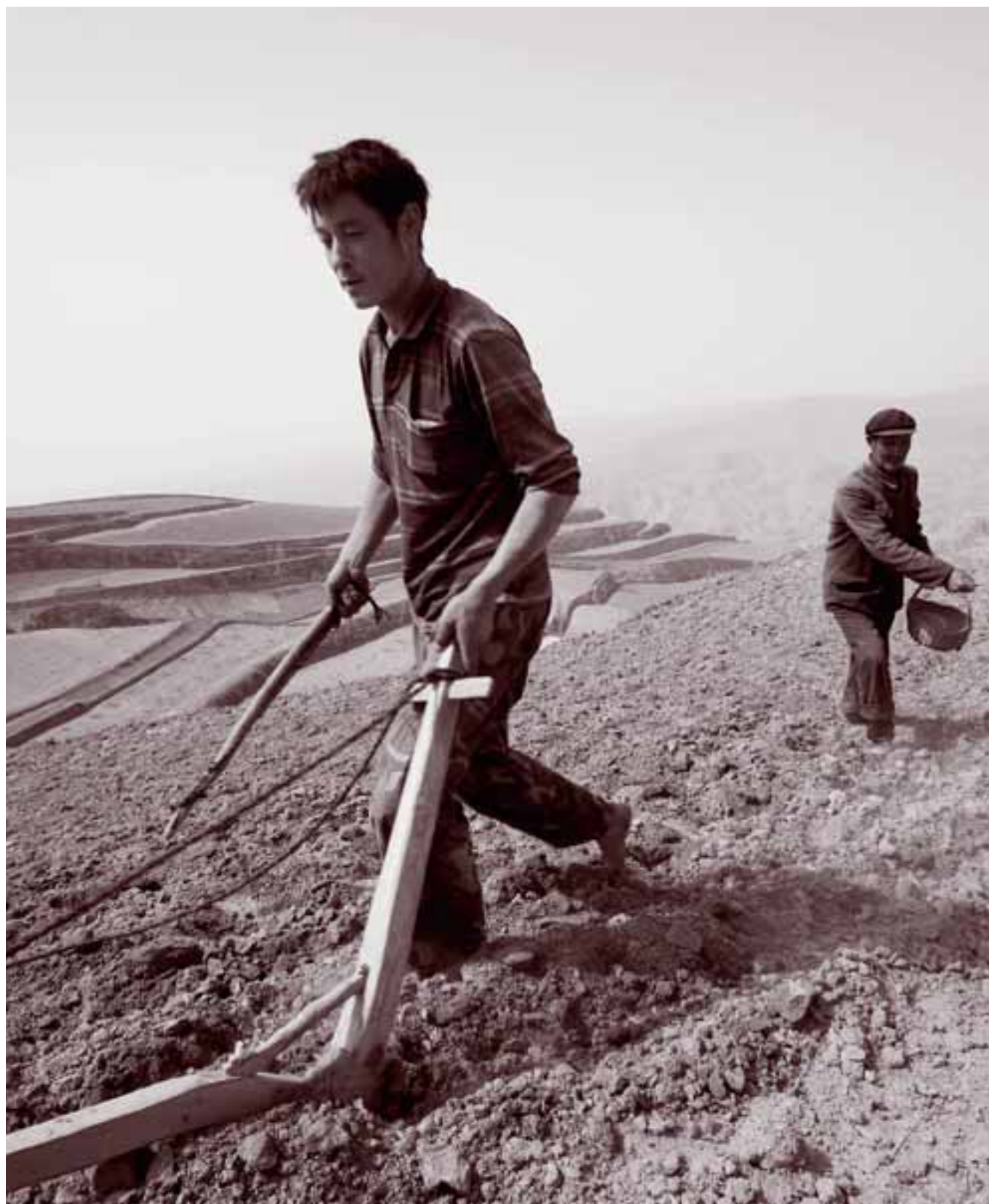




# 4

## THE EVOLUTION OF IFAD'S ENGAGEMENT WITH THE PRIVATE SECTOR





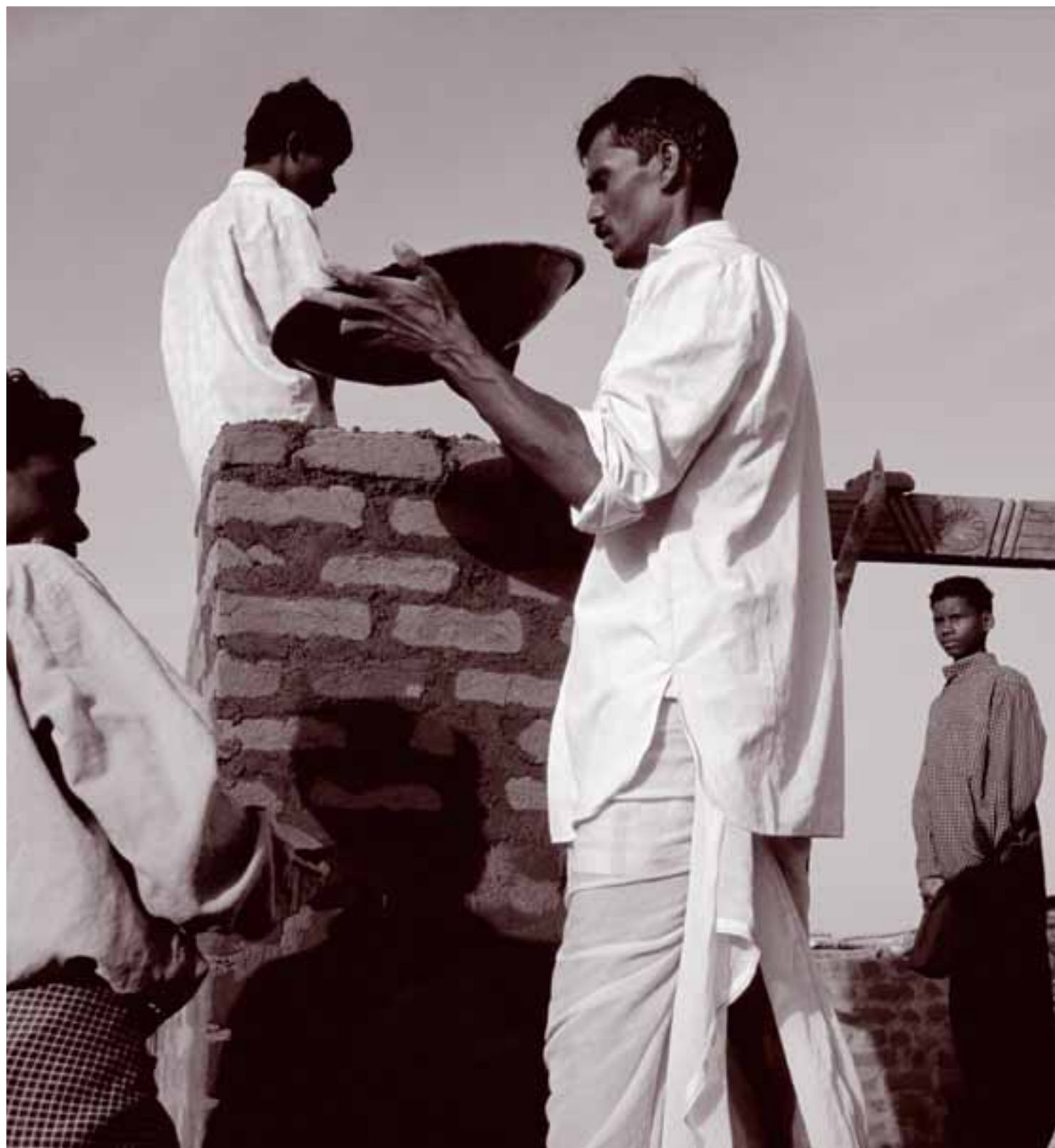
Since its foundation 28 years ago, IFAD has been supporting the private sector as represented by smallholder farmers and other rural poor residents. In the early days, however, the rural poor were looked upon mainly as local producers with few linkages to the rest of the economy. Indeed, early IFAD-supported projects focused mainly on boosting food production and improving the food security of rural households (within a largely 'subsistence economy' model). This called for financing the delivery of non-market-based, public rural services (such as extension, credit and infrastructure) and the capacity-building of public institutions.

As noted earlier, the environment in which IFAD's target groups produce, work and obtain services has changed substantially over the past ten to 20 years. The withdrawal or reduction of the state's role in providing services and purchasing output means that the private sector is increasingly fulfilling this role, or is at least expected to do so. Therefore, smallholders and other rural entrepreneurs are now private-sector actors operating in a much wider and dynamic context. New, private-sector-driven economies have created real opportunities for many rural poor residents, but there are also major challenges. Left to themselves, markets for goods and services in poor rural areas are not automatically more efficient than the state-led or mixed systems they have replaced, and even where they are, they certainly do not guarantee benefits to poor and unorganized rural producers.

Today, IFAD recognizes that it is not enough to focus narrowly on increasing crop production. Instead, a broader approach that also supports the establishment of viable backward and forward linkages between rural producers and surrounding private markets is essential in

order to enhance the income and livelihoods of rural people. Supporting private-sector entities (e.g. input suppliers or agro-processors) that can provide commercially viable services and markets for the rural poor is becoming an increasingly important component of sustainable rural development programmes. The off-farm sector may also represent an important source of income, especially for the poorest segments of the rural population, e.g. rural women, youth and the landless.

Establishing market linkages and supporting private rural enterprises require a new set of policies, instruments and means of engagement between the public and private sectors, with appropriate support from external donors. Although IFAD works mainly through the public sector, the resources that it brings to bear can be used to help establish an enabling policy and institutional framework for rural private-sector development. These resources can also finance critical public goods and services so that private-sector markets can be made to work more efficiently and on terms more favourable for the rural poor. IFAD can also leverage additional resources from the private sector through its catalytic role in mobilizing funds, its willingness to partner with others, and its efforts to explore new and innovative ways to enhance the impact of its operations.



# 5

## THE APPROACH OF OTHER DEVELOPMENT ORGANIZATIONS TO PRIVATE-SECTOR DEVELOPMENT AND PARTNERSHIP

During preparation of this strategy paper, and in order to learn from the experiences of similar agencies, the private-sector development and partnership strategies of several bilateral and multilateral development organizations were reviewed.<sup>6</sup> The review showed that the respective approaches to working with the private sector relate to the specific mandate and underlying policy orientation of each organization. It also revealed that most organizations emphasize the importance of balancing the role of the state with that of private initiative. Other strategic issues that were deemed important by these organizations included: enhancing the policy and regulatory environment for private-sector development; supporting the development of well-functioning local and national markets and extending the reach of markets to all people; capacity-strengthening and technical assistance to build human capital and improve professional skills; and promoting good governance and different forms of public-private partnerships. In general, the trend was towards flexible policies that allowed partnerships to be forged on a case-by-case basis, with attention to due diligence as an important factor in the choice of partners. There are lessons to be learned from the experiences of these organizations, as well as opportunities to establish operational partnerships with them.

Within the development community, there are a number of organizations and international financial institutions (IFIs) that provide support directly to the private sector in developing countries (often with the endorsement of the government). These include the International Finance Corporation and the European Bank for Reconstruction and Development. These organizations usually provide loans, equity and quasi-equity financing for private-sector projects. They also help private-sector

companies in developing countries to mobilize resources from international capital markets. IFAD will take advantage of the existing involvement of these IFIs with the private sector and try to establish partnerships with them in support of the rural sector in areas such as the promotion of small and medium enterprises (SMEs) and microfinance and the establishment of an appropriate agribusiness environment. Similarly, public funds (e.g. the Canada Investment Fund for Africa) and the private funds of large corporations (e.g. the Bill & Melinda Gates Foundation, the Ford Foundation, the Deutsche Bank Microcredit Development Fund) also finance private-sector investments in developing countries. There are opportunities to link with these organizations as well, in order to attract additional resources to rural areas.

A number of important donor initiatives have sought to tap the corporate social responsibility of private-sector companies in support of local and international development. In this regard, the Global Compact was launched in July 2000 in response to a call by Kofi Annan, the Secretary-General of the United Nations (UN) at the time, for business leaders to work with the UN to "initiate a global compact of shared values and principles, which will give a human face to the global market".<sup>7</sup> The Global Compact has already established partnerships with over 1,400 private-sector companies to adopt appropriate corporate policies in terms of human rights, labour standards and environmental sustainability. Given the very broad reach of this initiative and IFAD's particular niche within the UN, there is limited scope for IFAD to contribute substantially to it.

The report *Unleashing Entrepreneurship: Making Business Work for the Poor* specifically states: "the savings, investment and innovation that lead to development are

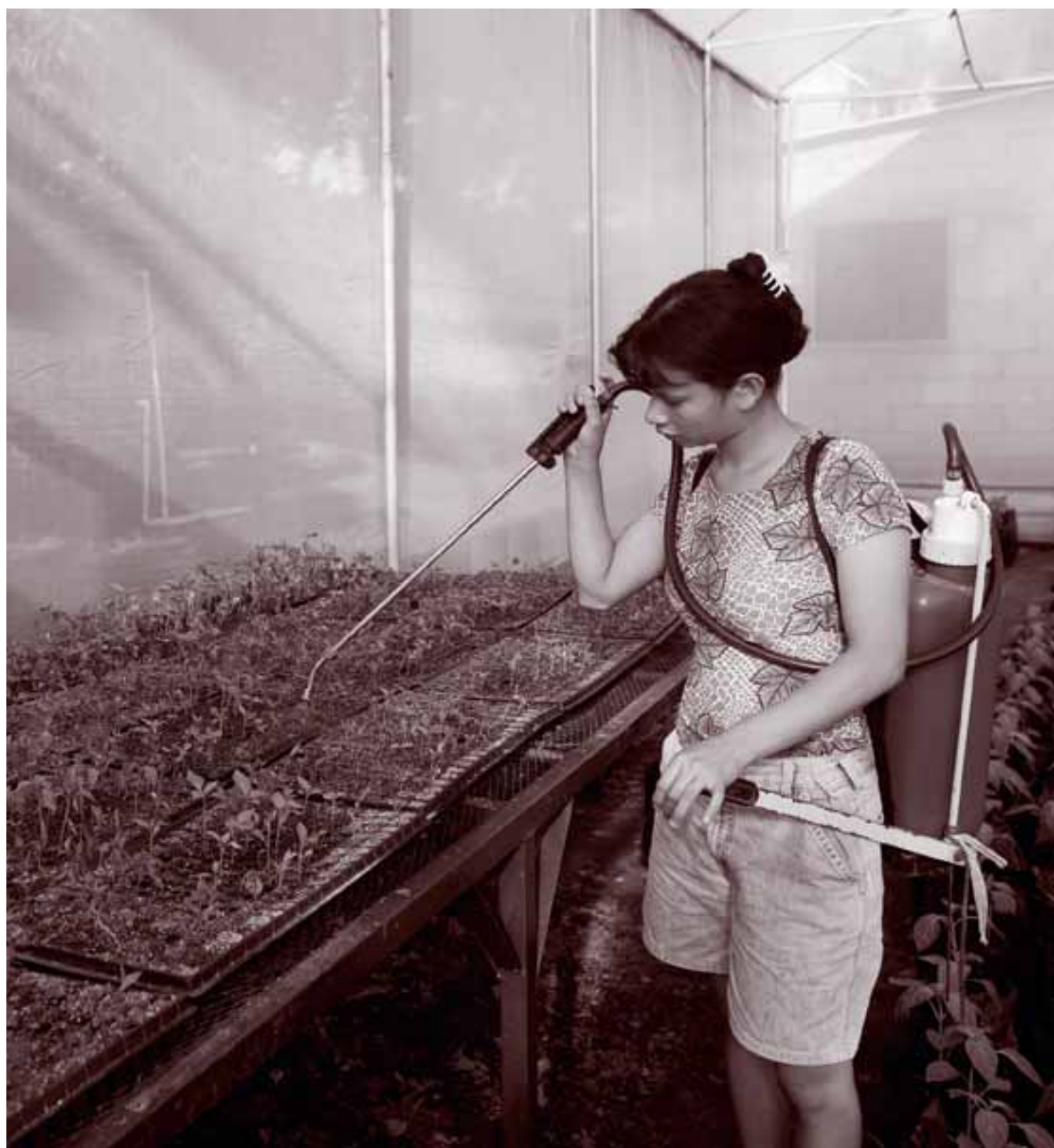
<sup>6</sup> The following organizations were studied: the World Bank, Asian Development Bank, African Development Bank, Inter-American Development Bank, Islamic Development Bank, the Canadian International Development Agency, the Department for International Development (United Kingdom), the German Agency for Technical Cooperation, the Swedish International Development Cooperation Agency, the United Nations Development Programme and the United States Agency for International Development.

<sup>7</sup> Excerpt from the report *Assessing the Global Compact's Impact* prepared by McKinsey & Company in preparation for the Global Compact Leaders Summit, which convened on 24 June 2004 at UN Headquarters.

undertaken largely by private individuals, corporations and communities". The report makes a series of recommendations on the role of the public and private sectors (including multilateral development institutions and civil society organizations) in unleashing and fostering the private sector in developing countries. For multilateral institutions, the report calls for the application of the Monterrey recommendation on specialization and partnership to private-sector development activities; such recommendations are followed through in this specific strategy for IFAD.

# 5





# 6

THE WAY FORWARD:  
A PRIVATE-SECTOR DEVELOPMENT AND  
PARTNERSHIP STRATEGY FOR IFAD

## Goal, objective and guiding principles

The goal of the private-sector development and partnership (PSDP) strategy is to engage the private sector to bring more benefits and resources to IFAD's target group, the rural poor. The more immediate objective of the strategy is to increase pro-poor private-sector operations and investment in rural areas. Before describing the activities that IFAD will undertake in order to achieve this, it is important to highlight that IFAD's strategy for PSDP will be based on the following key guiding principles.

**Focus on IFAD's comparative advantage and mandate.** IFAD's comparative advantage lies mainly in its experience in working with the rural poor through its projects and programmes, its participatory and bottom-up approaches to development, and its willingness to take risks and explore innovative means to help the rural poor lift themselves out of poverty. IFAD's strategy for the private sector will capitalize on this comparative advantage and will apply a bottom-up approach in working with this sector. In essence, IFAD – through its projects and programmes – will support or partner with the private sector only if and when this is to the benefit of its target group, the rural poor.

**Base the strategy on IFAD's strategic framework.** IFAD's Strategic Framework 2002-2006 expresses how IFAD believes it can best contribute to the achievement of the Millennium Development Goals. As defined in the strategic framework, IFAD's mission, or overall institutional goal, is "to enable the rural poor to overcome poverty". The framework identifies and prioritizes a number of broad but key areas in which IFAD will work in order to fulfil its mission. The strategic framework is thus central to everything that IFAD does: it provides the rationale and goal for all of IFAD's operations and activities, and it guides all of IFAD's

internal and external business processes. For this reason, it is appropriate that an IFAD-specific PSDP strategy be built around the strategic framework. And as stated in the strategic framework, partnerships with other players are needed, including with the private sector.

### **Build on IFAD's experience and catalytic role.**

IFAD's PSDP strategy will build on the organization's experience in policy dialogue, investment operations and work with the private sector, as it involves and affects the rural poor. Through its projects and programmes, IFAD plays a catalytic role in developing a solid foundation for policy dialogue and change; establishing a platform for partnerships with different stakeholders, such as governments, NGOs and the private sector; and creating more favourable conditions for attracting additional resources to rural areas. The value added of IFAD interventions can therefore be much larger than the sum of its investments: by acting as a catalyst, IFAD resources can leverage a much higher level of investments from the private sector and other partners in rural areas. It is important to note that IFAD will continue to work through its Member States and that the public sector has an essential role to play in establishing the appropriate framework and conditions for the development of a vibrant private sector and for building sustainable partnerships with it.

**Operate within its resource capacity.** IFAD's PSDP strategy will operate within the size and capacity of the organization's resources (both financial and administrative). Accordingly, the most likely scenario is that partnerships with the private sector will start with initiatives that can be undertaken with IFAD's current staff and financial capacity. These initiatives, and the approaches associated with them, would then be replicated or scaled up gradually as IFAD's experience and knowledge in this area grow and as momentum picks up following more intensive involvement with the private sector.

**Learn from the experiences of other development organizations.** As mentioned in Section V above, IFIs, the UN system and bilateral development agencies are all working with the private sector. As part of the preparation of this strategy, IFAD organized a workshop in 2003 and invited several organizations to present their current strategy and experiences of working with the private sector. Networking, sharing of experiences and the development of partnerships with other institutions working on these issues will continue to enhance IFAD's strategy and provide new information and tools that could be used to expand and improve upon it.

**Draw on the Initiative for Mainstreaming Innovation.** Working with the private sector will require IFAD to develop new approaches and innovative ways of doing business with its partners, or to enhance and modify its existing mode of working with others. Mainstreaming innovation into IFAD's core activities includes identifying new or improved ways of partnering with the private sector in order to increase the effectiveness of achieving IFAD's strategic objectives. IFAD will thus draw on the Initiative for Mainstreaming Innovation (IMI) to support and strengthen its core activities with the private sector. In fact, in 2004, IFAD used IMI funds to prepare an operational manual that will guide IFAD staff in their engagement with the private sector (see the Guidelines, staff training and staff realignment section on page 38). Another related IMI preparatory phase project has produced a report on *Partnering for Market Access and Market Development*, as well as manuals and tool kits to help guide interested IFAD target groups in accessing markets.

## Operational strategy and underlying outputs and activities

The PSDP strategy proposed below is based on all the aforementioned interlinked elements, but it is organized along three broad lines of action: (i) **policy dialogue** for local private-sector development; (ii) **investment operations** to support local private-sector development; and (iii) **partnerships** with the private sector in order to leverage additional investments and knowledge for rural areas. The main outputs to be achieved and activities to be undertaken under each line of action are presented below. The annex contains a results framework summarizing the operational strategy of the PSDP in terms of the underlying objectives and outputs, performance indicators, monitoring and evaluation mechanisms, and the assumptions or risks involved.

### (i) IFAD will engage in policy dialogue in order to provide an enabling policy and institutional environment for local private-sector development

In addition to an appropriate macro-level institutional and policy framework, attracting private investment to rural areas in support of the rural poor and their productive activities requires enabling policies and institutions in the rural sector. The strategic framework highlights IFAD's catalytic role in promoting pro-poor growth and bringing about policy and institutional development in this sector. Based on its operational experience, IFAD will strive to engage in dialogue with governments and other relevant partners to effect policy and institutional change in favour of the rural poor and those segments of the private sector that support them.

As elaborated in IFAD's performance-based allocation system (PBAS), strong sectoral performance is often related to the state's ability or willingness to create an appropriate policy, legal and regulatory framework that is

supportive of market-based relations among the rural poor and with the private sector. The PBAS includes, for example, indicators related to the ability of farmers to organize into groups, the investment climate for rural businesses, the enabling conditions for rural financial services and agricultural markets. Thus, the PBAS will help identify areas of focus for IFAD in its policy and institutional dialogue with governments and other key stakeholders in support of private-sector development and the market-based activities of poor rural producers.

In operational terms, this means that all new IFAD country strategic opportunities papers (COSOPs) will include a review of the appropriate policy and institutional environment for local private-sector development (including a review of the PBAS indicators on this issue). The new COSOPs will also incorporate the Fund's strategy to engage in policy dialogue with various stakeholders, including the country's government, in order to promote local private-sector development. Furthermore, all COSOP consultation processes will involve the relevant representatives from the private sector (e.g. farmers' associations, agribusiness firms, private microfinance institutions or commercial banks working in rural areas). In a few targeted countries where there is willingness on the part of the government, policy dialogue to support the local private sector will be included as a specific country-programme activity. This could take the form of dialogue on appropriate policies for private microfinance institutions, SMEs, agricultural input and output markets, and other measures to improve the business environment. Policy dialogue for local private-sector development will be especially emphasized in countries where IFAD has a strong field presence.

IFAD will also intervene at the global level to promote equitable commercial linkages for the rural poor. Developing countries are still coping with the persistence of non-tariff barriers and agricultural subsidies in member

countries of the Organisation for Economic Co-operation and Development, thereby limiting the access of their small producers to international markets. IFAD will therefore continue to use global policy forums to highlight the concerns of developing country producers and reinforce the call for levelling the playing field in international trade.<sup>8</sup>

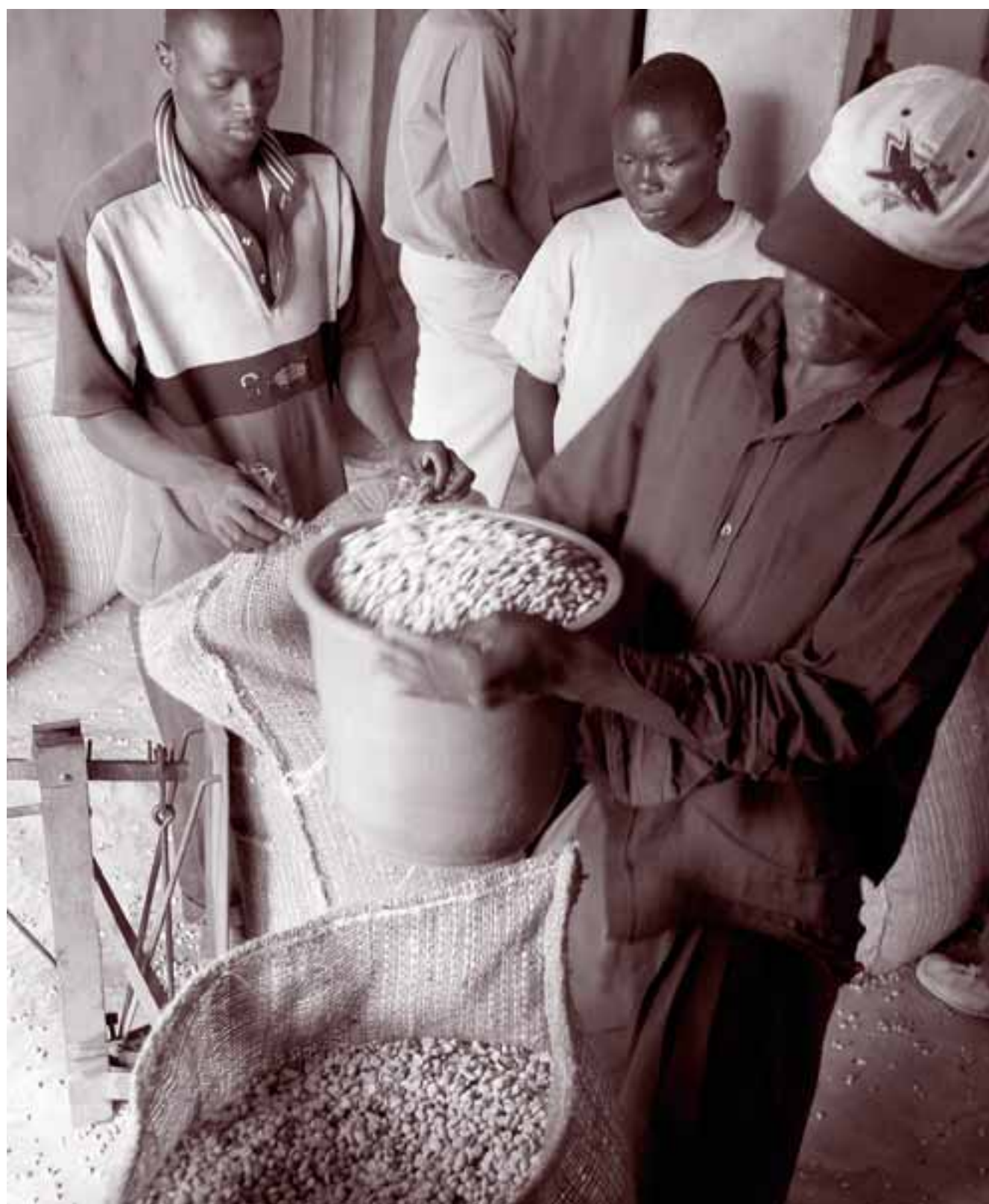
## **(ii) IFAD investment operations will support local private-sector development in rural areas**

IFAD's investment operations will support development of the private sector as it relates to improving the livelihoods of the rural poor. More specifically, there are a number of key areas where the Fund will play a role:

**Strengthening the business capacity of the rural poor and their organizations.** This will be one of IFAD's most critical areas of intervention, and it will be a crucial element in equipping the rural poor to face new market forces and to partner with the surrounding private sector on a more equitable basis. Many rural poor people lack the skills and knowledge to become better farmers, workers, entrepreneurs or traders, and thereby to increase their incomes and contribute to the development of the rural private sector in general. Furthermore, the costs of interacting with the surrounding private sector (e.g. in order to access services, obtain information, buy or sell products, or manage resources) are often prohibitive for rural poor people when acting individually. The private sector, in turn, is often reluctant to invest in rural areas because of the high transaction costs and the risks involved in dealing with dispersed, unorganized and poor rural dwellers. In certain situations, private operators take undue advantage of their market power and the social and economic weakness of the rural poor, delivering substandard services or charging (and/or offering) unfair prices. In some cases, they may try to restrict the market access of new entrants, especially of weak socio-economic groups such as poor women and minorities.

<sup>8</sup> See the IFAD discussion paper on *Trade and Rural Development: Opportunities and Challenges for the Rural Poor* (GC 27/L.10) for an in-depth discussion on the role of markets and trade in reducing rural poverty.







Of particular importance in the emerging private-sector markets are farmers' organizations or producers' cooperatives built around a common economic purpose. Not only do they promote market exchange by reducing the costs of market transactions for both small-scale producers and private-sector market intermediaries (a win-win situation for both parties), but they also help protect the rights of their members and make these exchanges more equitable for them. They enhance the bargaining power of their members, allowing them to receive higher and fairer prices for their products, pay lower costs for inputs, claim their rights to access assets such as land and water, and demand accountability from local service providers. In many instances, farmers' organizations also form savings and loan associations, thereby improving the access of their members to financial services. Therefore, IFAD will promote the formation of farmer-owned organizations: it will work with existing organizations where possible, but it will also assist farmers in establishing their own organizations where none exist. Working through experienced trainers/mentors, IFAD will foster the development of cohesive, sustainable, business-focused producer groups in the projects and programmes it supports.

IFAD will also invest in strengthening the business capacity of rural individuals as well as their organizations through training, technical assistance and the use of participative approaches to rural development. Strengthening rural organizations (such as village associations, self-help groups, farmers' associations or producers' cooperatives, water users' associations, women's groups, and savings and credit associations) empowers the rural poor to enter into more equitable and informed relationships with private market agents (see Box 2). Village-based savings clubs can represent the first step towards entry into financial markets for the rural poor. Water users' associations can strengthen the capacity of poor rural water users to manage water resources more efficiently, while demanding better water services from public or private suppliers.

**Improving the access of the rural poor to private technical/advisory services.** Some technological innovations that hold potential for rural communities now come from the private sector. These include the treadle pump (a low-cost irrigation technology), water-saving technologies (such as drip irrigation), crop production and protection technologies

## BOX 2

### **Solidarity gives women access to financial services and the market: the case of self-help groups in Chattisgarh, India**

The most vulnerable groups in India, especially women, often lack access to financial services and face rigid societal barriers that prevent them from participating in economic activities outside their immediate neighbourhood. Accordingly, in 1987 IFAD started assisting the formation of women's self-help groups (SHGs) in India. So far, around 22,000 SHGs with some 370,000 women have been formed under various IFAD-supported projects. This approach has proved effective not only in granting women access to microfinance and markets, but has been responsible for important changes in social patterns and norms, which have led to the empowerment of women.

A review of an initiative in Chattisgarh shows that women's SHGs in India have evolved and are now introducing economies of scale in their own operations. Although the SHGs initially borrowed mainly for consumption reasons, for example to cover expenses generated by marriages, sickness of a family member or children's education, they are now using loans for productive group activities. Three of the SHGs are using their savings to

(including seeds, fertilizers and pesticides), information and communication technologies, and post-harvest and agro-processing technologies. IFAD will work together with small farmers and rural entrepreneurs to improve their access to these technologies, and test and adapt them through capacity-building, demonstrations, and farmer exchange activities. It will provide support to farmers to access the technology more cost-effectively by organizing them into groups and by establishing relationships between them and the providers of these technologies (including through contract farming mechanisms).

In the area of advisory services, both the financing and the delivery of these services are increasingly seen as spheres in which the private sector should be engaged, and from which governments can disengage. Advisory services – generally commodity-specific – are increasingly being financed by producers' associations, input suppliers or marketing/processing companies. Even in some countries where the state is still engaged in providing these services, delivery has been opened up, on a contractual and competitive basis, to specialized private-sector suppliers. In those countries, IFAD will play a catalytic role in

helping to launch these innovative public-private partnerships, which will benefit both the recipients and the providers of advisory services. In countries where the move towards privatized advisory services is more advanced (such as in Latin America, Asia, and Western and Central Africa), IFAD projects and programmes will rely on the private sector to deliver advisory services to its beneficiaries.

**Supporting the development of private rural financial institutions.** Rural finance, as a commercial activity, has been provided mostly by the private sector.<sup>9</sup> Since its beginnings in the 1970s, microfinance has grown dramatically, and whereas access to rural microfinance services was initially promoted by NGOs and financial cooperatives, the evolution over the past ten years has shown growing involvement by commercial banks and non-bank financial institutions. In many countries, commercial banks are realizing that providing financial services to the poor, either directly or indirectly (through NGOs), is a promising endeavour, not only in terms of image and social accountability but also in terms of business propositions. Many NGOs have also transformed themselves into licensed commercial institutions upon becoming financially sustainable, in order to diversify their



<sup>9</sup> The private sector in rural finance may be broadly defined as a sector where state control and ownership are absent. It would typically include NGOs specialized in rural microfinance, financial cooperatives, non-bank financial institutions and full-fledged private commercial banks. The last two categories are often referred to as the 'commercial' private sector.

buy Mahua flowers, which they will store and resell once the price has risen. Another SHG has begun to grow vegetables on land belonging to one of its members. The vegetables produced are considered as belonging to the SHG and are thus sold either to SHG members or at the market. The profit made remains with the SHG, with a portion shared out equally among the members.

The collective identity of the women belonging to SHGs has also helped them to tear down illegal barriers against entry into the market. Members of the SHGs and two nearby villages reported that one of the traditional Mahua buyers at the market had told them that: (i) they were not entitled to buy Mahua flowers, and (ii) if they persisted, he would send them to jail for three years. Instead of being intimidated, the women lodged a complaint against the trader at the police station (42 women from the three villages signed the letter of complaint). The project staff reported that this is the second time that the women had gone to the police station to defend their rights against injustices. Prior to the formation of the SHGs, the women would not have dared to compete with established market traders to buy produce and, when threatened, they would have been intimidated into leaving the market. Thanks to the SHGs, not only have the women diversified their economic activities, but also they feel sufficiently empowered to defend their right to access the market.

services as well as their funding sources (borrowing from banks or raising equity). In many countries, the frontiers between rural microfinance and the national financial sector have started to overlap, with the private sector leading the industry's expansion.

As with any private-sector entity, rural microfinance institutions need to become sustainable in order to expand and diversify their services independently of donor support. Beyond savings and simple insurance services, the past few years have witnessed growing interest among donors and financial institutions in transfers and remittances, which in some regions far exceed the volume of official development assistance.<sup>10</sup> The growing involvement of the private sector has been paralleled by a declining engagement of the state in the provision of financial services. Microfinance was originally born as a way to overcome the inability of state-controlled development banks to reach the poor successfully and sustainably. IFAD's policy reflects this shift, as it is moving away from extending credit lines through state-owned financial institutions and towards promoting access to varied financial services through

a wide array of rural finance institutions belonging to the private-sector sphere.<sup>11</sup>

The burgeoning development of the rural microfinance sector represents an opportunity for IFAD as it strives to strengthen its approach and instruments in this evolving field. IFAD's primary institutional partners are (and will remain) its Member States. IFAD lends to governments, which pass loan proceeds on to selected rural financial institutions (RFIs), either as loan principal or grants for capacity-building and institutional strengthening. IFAD also has access to grant instruments, although to a lesser extent, which it can use for direct support to RFIs in the field.

To respond to the evolving needs of this sector, IFAD will adapt the use of its loan instruments. For example, it has helped RFIs to leverage quasi-equity in their borrowing from local banks. In Armenia, an IFAD loan was transferred as subordinated debt/quasi-equity in favour of the local institution, the Agricultural Cooperative Bank of Armenia, which became the country's first cooperative bank and one of its most successful financial institutions (see Box 3). Quasi-equity can also be useful when

<sup>10</sup> The total volume of remittances around the world is believed to amount to more than US\$100 billion.

<sup>11</sup> It should be noted that a few state-controlled financial institutions have succeeded in developing innovative approaches to providing financial services to the poor (e.g. loans, savings and remittances), namely in China, India and Indonesia, and have benefited from donor engagement and support (see the IFAD publication *Decision Tools for Rural Finance*, Part I, Chapter 2).

## BOX 3

### The experience of the Agricultural Cooperative Bank of Armenia

Following implementation of the land reform programme in Armenia, it became clear that existing, former state banks, despite their extensive network, were unable or unwilling to meet the demand for financial services from the country's many small farms: they shied away from the perceived risks and lacked the required know-how. Therefore, with support from donor funding, a feasibility study was conducted on the establishment of a rural bank. The study recommended the gradual establishment of an agricultural cooperative bank, applying a bottom-up approach to define the governance structure. On this basis, the Agricultural Cooperative Bank of Armenia (ACBA), a private bank, was born. ACBA is widely acknowledged today as a model financial institution for transitional economies.

ACBA owes much of its success to the support received from leading international agencies and donors. The support provided by IFAD, in particular, has played a pivotal role in the bank's growth. The experience with ACBA illustrates innovative ways of using IFAD's concessional loans to foster private-sector development in favour of the rural poor. In ACBA's case, this innovation was embodied in the manner in which support was provided to the development of the institution.

provided to second-tier institutions that refinance local RFLs. One such example is the direct lending to the Small Industries Development Bank of India under the sovereign guarantee of the Government of India. This allowed the bank to obtain the full term of an IFAD loan (40-year repayment) and thus treat it as quasi-equity. It has used the loan to leverage other loan funds on the local market. A stronger focus on technical assistance needs, a prudent approach to lending and innovative ways to help RFLs access quasi-equity all reflect a shift in the way RFLs are supported. IFAD's aim is to support and scale-up private RFLs that can promote access to financial services for a large number of poor people in rural areas.

**Supporting the development of private agricultural markets and small and medium enterprises, and their effective linkage to rural poor people.**

The strategic framework explicitly recognizes that in a world where markets for agricultural and agriculturally derived products are now almost entirely private-sector-based, efforts to increase agricultural productivity can be effective only if they are linked to an appreciation of market potential and to effective engagement by poor

producers in those markets. It thus calls for integrated approaches along the full continuum of production, processing and marketing.

The recognized importance of market linkages for the rural poor implies the need for capacity-building and investment in activities that are commercially viable on the market.<sup>12</sup> Once the market becomes the organizing principle for livelihood development for poor people, particularly for smallholder producers, IFAD interventions will have to adopt a multistakeholder, holistic approach that involves all actors operating in markets. In practice, IFAD-supported projects and programmes in market-linkage development will work in one of two ways.

The first will be to focus on the supply chain for a particular commodity. A number of projects will undertake a thorough analysis of specific commodities or products of economic importance to the poor, examining the whole chain from producer to consumer, and then address the weak, or even missing, links in the chain. Depending on the product involved, the weak links may relate to the organization of farmers or the availability of finance and

<sup>12</sup> See the IFAD discussion paper on *Promoting Market Access for the Rural Poor in Order to Achieve the Millennium Development Goals* (February 2003).

In the late 1990s, the Armenian Ministry of Finance, ACBA management and IFAD agreed that IFAD resources could be accessed by ACBA both as a grant and as a loan. IFAD financed support to ACBA in the amount of US\$4.55 million, split into two parts: a grant in the amount of US\$2.35 million and a loan for US\$2.2 million. The Ministry of Finance also agreed that any loan funds made available to ACBA could be provided on IFAD conditions, in terms of grace period and maturity.

This arrangement of using the concessional element of IFAD's support in an innovative manner had several advantages. The increase in the capital base of the bank, through the resources provided by IFAD, contributed to sustainability and potential growth in a direct and immediate manner, something that could not have been achieved by an ordinary credit line. Apart from positioning it to respond to tighter National Bank requirements, the increased capital base enabled ACBA to enhance its outreach in rural areas much more quickly than would have otherwise been possible.

In the period from March 1998 to November 2003, the resources provided by IFAD to ACBA served to disburse a total of 21,580 loans to farmers for a total value of US\$14.8 million, indicating that, on average, funds had already revolved three times. Average annual growth in loan disbursements was 51 per cent, with an average loan size of about US\$700.

appropriate technology at the primary producer level; to finance technology and business planning skills at the processing level; or to appropriate tax regimes, export regulations or quality control at the wholesale level.

The second area for project intervention will be to focus on creating linkages between small farmers and private markets or intermediaries. To achieve this, a significant number of IFAD projects will directly assist smallholder producers in understanding better how markets work, how to gear their production to the demands of potential buyers, how to access markets, and how to negotiate better with private-sector market intermediaries. In this effort, it will be critical to provide support for the establishment of commercially oriented organizations (groups, associations, cooperatives) and training for these organizations so they can develop the understanding and skills required to interact effectively with markets. Support for improved techniques for production, storage, packaging and processing will be an essential element in enabling producers to respond to market requirements.

IFAD-supported projects and programmes will also help bring producers and market intermediaries together. The kind of support this requires varies considerably. It will cover essential physical infrastructure – primarily roads – enabling buyers and sellers to transport their products. It will also promote market/price information and communication, by such means as mobile telephones, Internet-based systems and the setting up of trade fairs or market days, which provide an opportunity for buyers and sellers to meet. Contract farming between agricultural marketing companies and small farmers is another mechanism that will be supported by IFAD. For farmers, this arrangement ensures access to inputs on credit and access to output markets. For private traders, it guarantees a certain quantity and quality of supply on a timely basis (see Box 4). Despite the establishment of mutually beneficial market linkages however, there are some risks associated with contract farming, including exploitative behaviour on the part of traders, or side-selling by farmers. IFAD's support to contract farming will therefore attempt to find solutions to such potential problems.

## BOX 4

### **Agricultural marketing companies as sources of smallholder credit in eastern and southern Africa**

In eastern and southern Africa, commercial relations between smallholder producers and agro-processing/marketing companies have developed rapidly over the past decade, and they are now an important feature of the rural economic landscape. A key element of these relations is the companies' provision of input credit to their contracted producers. To learn more about this, in 2003 IFAD carried out a review of the agricultural credit operations of marketing and processing companies in Kenya, Mozambique and Zambia. The aim was to gather information that would be useful in developing interventions for promoting private, non-financial rural credit provision and farmer-to-market linkages.

Input credit provided by companies through interlocking arrangements to buy the borrowing smallholders' crops under farming contracts was found to be an important *modus operandi* in all three countries. In Kenya, the largest company-financed smallholder credit operation is in the tea sector, the country's main export crop, where the Kenya Tea Development Agency Limited provides all the fertilizer required to cultivate high-quality tea to 406,000 smallholders. Contract farming is also prevalent in the fast-growing horticultural sector, in the sugar industry and in the tobacco subsector. In Mozambique, both the contracting of smallholders and the provision of company input credit are principally associated with cotton and tobacco companies operating on government-allocated concessions. In Zambia, the largest company credit schemes operate in the cotton subsector, but other, much smaller company-financed input credit schemes exist for paprika, tobacco,



Another important initiative for private-sector development in IFAD will be based on supporting local SMEs to deliver services and provide jobs or markets to the rural poor. IFAD believes that SMEs have a crucial role in generating rural employment and stemming rural-urban migration, attracting knowledge and skills to the rural areas, providing essential backward and forward linkages between primary producers and other market intermediaries, and stimulating rural economies in general. Supporting SMEs is also an essential component of the supply-chain approach that IFAD will adopt (as described on page 29) in addressing the agricultural production and marketing bottlenecks facing small farmers. For this reason, a number of interventions will support rural SMEs so that they can provide more competitive and efficient services to smallholders, particularly for input supplies, agro-processing and produce-marketing. The sort of support envisaged includes basic training in business and financial-flow analysis, training in new technologies, credit provision, or the linking of rural entrepreneurs to producers or other market intermediaries along the market chain.

**(iii) IFAD will partner with the private sector to leverage additional investment and knowledge in rural areas**

This paper has so far focused on various ways and means for IFAD to promote development of the local private sector in order to improve the livelihoods of the rural poor. As mentioned earlier, developing the local private sector, including helping the rural poor to reduce their poverty, could also benefit from partnerships with the national and international private sector as a source of funds, skills and innovative models. The role of the state will of course remain essential in providing the appropriate policy, legal and institutional environment for rural poverty reduction; ensuring the necessary regulatory framework to engage the private sector; and investing in public goods that serve the economic and social needs of its people. The intention is for the private sector to complement the public sector by acting as a source of investment and knowledge for rural poverty reduction and economic growth.

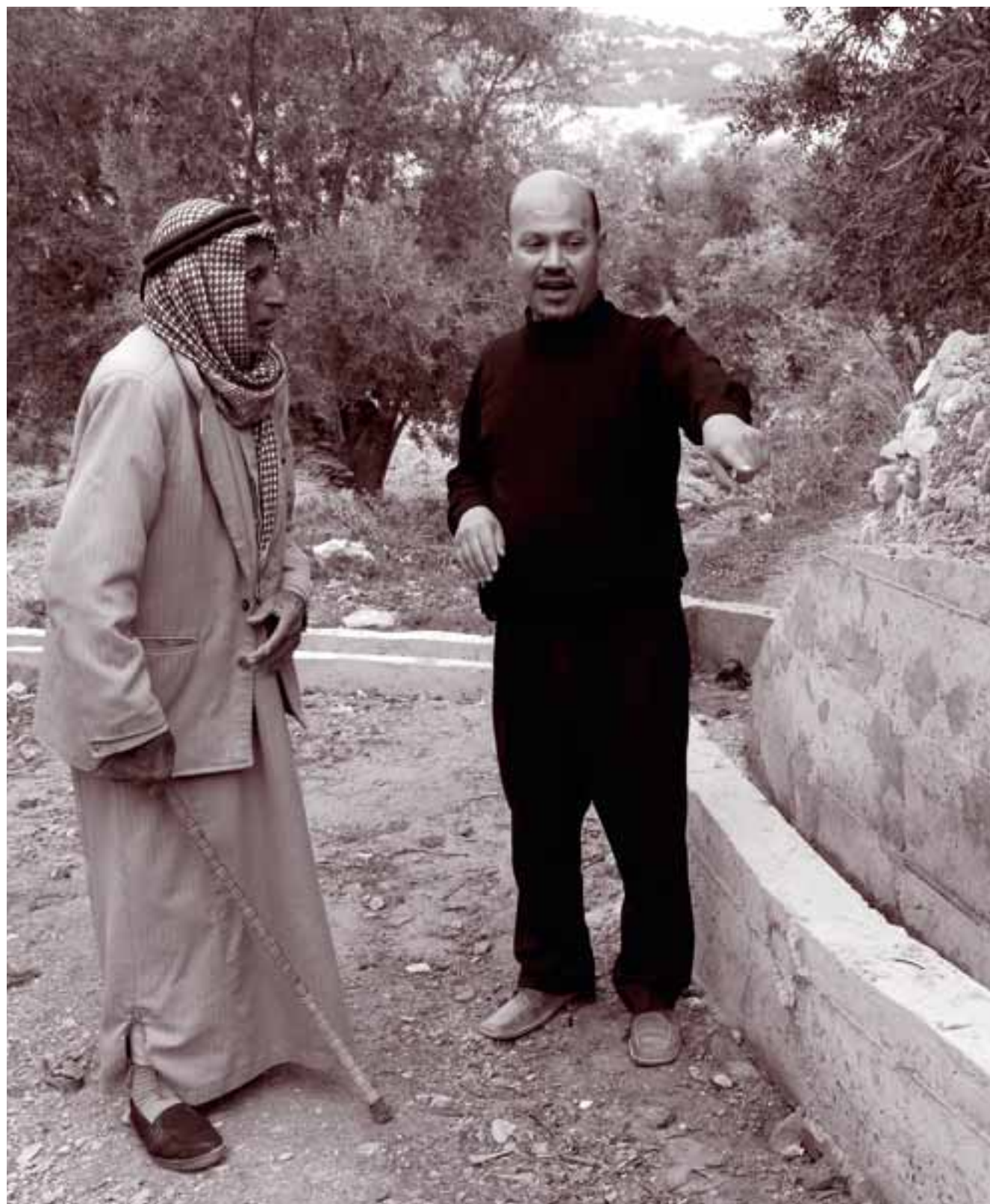
Thus, working with its partner governments, IFAD will actively seek to leverage investments from the private business sector and from

vegetables and maize. In all cases, the processor or marketing company supplies inputs to farmers on credit in order to help secure produce of sufficient quantity and quality; the credit enables farmers to purchase necessary inputs to which they would not otherwise have access.

The review concluded that most contract farming schemes have the potential to benefit both the company and the farmer. Such arrangements can provide solutions that enable small producers to access improved technologies, financial services and agricultural produce markets, even in difficult operational environments. They can also serve as an important element in improving the chances of smallholders to participate in the production of high-value crops. In some countries, such farming schemes provide a unique link between small-scale farmers and international markets.

The review also showed that such credit operations can be profitable for marketing companies – even with high transaction costs and a relatively high default rate, provided they secure an adequate supply of quality produce. The major problems they face relate to their ability to procure the expected qualities and volumes of crops from contracted smallholders; these problems are sometimes exacerbated by contracted farmers' side-selling to opportunistic competitors, and by problems of law enforcement in contract farming and the lack of an appropriate code of conduct for both companies and farmers.

The review suggests that IFAD could play an important role in supporting further development of this kind of commercial relationship, and it makes a number of concrete recommendations as to how this could be achieved.



private donation funds<sup>13</sup> in support of the development projects and programmes it finances. Engagement by this sector will include project cofinancing or new parallel investments, made attractive through project risk-sharing or through projects that reduce the investment or transaction costs of private-sector partners.

In the cofinancing approach, the private-sector partner enters the project as it is being developed, risking its own funds in order to gain access to new markets. Cofinancing modalities, however, are likely to remain limited in scope since, for the potential private-sector partner, they entail substantial costs (the tying-up of funds over a long period) and high risk (delays or project non-performance). Only a few private-sector companies are likely to be willing to assume these. A more promising approach for IFAD will be to use already operational projects as a basis for catalysing private-sector investment. IFAD can use its concessional lending instruments in an innovative manner to leverage additional investments from the private sector. In this case, the infrastructure or activities financed by the project will make it more attractive for the private-sector player to make new investments in the expectation of developing new markets for its services or products.<sup>14</sup> The investments or activities supported by IFAD would thus serve to reduce the investment costs the investor has to assume in order to develop a new market and/or lower, for the potential investor, the transaction costs of doing business with the project target group.

IFAD will also look to attract investments from agribusiness firms in developing commodity markets that are of importance to small rural producers. What private agribusiness

companies would specifically seek from IFAD is its capacity to organize farmers into groups and broker their relationships with agribusiness firms. These companies emphasize that it is mainly local, field-based partnerships, working directly with the target groups, that will have the most impact and will be the most sustainable. These types of market linkages and partnerships will become more and more frequent as companies look to expand and diversify their supply sources. IFAD's strategy will be to tap into and look for partnerships that can be equitable for the rural poor and can help them access resources, services, and input or output markets. A number of pilot ongoing experiences provide lessons that can inform the development of a strategic approach in this area. For example, IFAD's partnership with Kaoka, a French chocolate producer and distributor, is not only bringing in Kaoka's knowledge of the cocoa market to help small farmers in Sao Tome and Principe, but will also lay the groundwork for a contract farming scheme to be established between Kaoka and the farmers (see Box 5).

Another area that IFAD will explore is leveraging migrant workers' remittances to attract knowledge and resources to rural areas. In Latin America, transnational rural communities are a new element in the landscape of rural poverty. Latin American migrants in the United States and Europe (the majority of them from rural communities) sent US\$38 billion back to their families in 2003. This means that the poor themselves are not only remitting much more than the sum of all financial contributions coming from IFIs, but have even surpassed the financial flow to some countries in the region from foreign direct investment and official development assistance. Through IFAD's catalytic role,

<sup>13</sup> While private foundations – such as the Bill & Melinda Gates Foundation or the Ford Foundation – are becoming increasingly important development partners, they are not dealt with in detail in this document. These foundations are non-profit, philanthropic organizations that act mainly as donors; therefore, partnerships with them would be included under IFAD's general resource-mobilization strategy. The types of private-sector partners that IFAD is seeking under this strategy are those that are driven by their own financial and commercial goals in partnerships with the rural poor through IFAD.

<sup>14</sup> IFAD projects often hire private-sector service providers to deliver project services to their beneficiaries. This will continue to happen but is not considered a component of IFAD's strategic partnership with the private sector. The latter focuses more on establishing a sustainable and long-term relationship between IFAD beneficiaries and the private sector, even after IFAD involvement is terminated.

migrant workers' remittances could have a higher multiplicative effect on investments in rural communities. Improving the capacity of local RFIs to serve migrants and their families with respect to remittances could help finance not only consumption but also income- and employment-generation activities (e.g. creation of microenterprises and small businesses) or collective investments (e.g. improvements to village infrastructure, including roads, healthcare services and schools). Migrants are also an important source of entrepreneurial skills and knowledge, which could be tapped when designing projects in their communities of origin. IFAD is currently piloting an innovative initiative in El Salvador where migrants are being incorporated as partners in design and project implementation.

IFAD will also seek partnerships with other UN organizations (including the United Nations Development Programme and United Nations Foundation), IFIs and regional development banks (e.g. the World Bank and the European Bank for Reconstruction and Development), as well as private development funds (such as the Deutsche Bank Microcredit Development Fund and the Rabobank Development Programme), in support of local private-sector development. For example, the Deutsche Bank Fund's strategy is to encourage and establish relationships

between local commercial financial institutions and microfinance institutions by providing funds as collateral for leveraged loans from commercial financial institutions. A partnership between IFAD and the Deutsche Bank Microcredit Development Fund could allow the latter to provide a loan for leverage of funds from national private banks to local RFIs, which can then focus on the delivery of financial services to poor rural entrepreneurs. More of these types of partnerships will be explored, specifically looking at how to help the local private sector reach out to the poor in their communities.

In operational terms, this means that at the COSOP stage, IFAD will explore possibilities to partner with either national (including migrant communities) or international private-sector companies in support of IFAD programmes. At the project design stage, specific opportunities for cofinancing or complementary investments from private-sector entities will be thoroughly examined. IFAD will also identify other development partners (as described in the previous paragraph) willing to enter into these strategic partnerships, and define common areas of intervention. For example, a tripartite partnership between IFAD, an IFI, and a private partner could be developed to provide financial and technical support to local SMEs in targeted countries.

## BOX 5

### Establishing a private-sector partnership for accessing knowledge and international commodity markets

Towards the end of the 1990s, it became increasingly clear that in order to raise small farmers' incomes in Sao Tome and Principe, IFAD needed a better understanding of the cocoa supply chain.\* Since IFAD had no specific knowledge of the market-side aspects of this chain, it decided to establish a partnership with Kaoka (the organic branch of the CEMOI group, a major French chocolate producer and distributor) in order to:

- tap the private sector's knowledge to obtain a better understanding of the market;
- tap the private sector's experience in terms of the tools and skills required for accessing the market; and
- use the private sector as a channel for accessing markets.

# 6

In developing partnerships with the private sector, there are two points of critical importance that need to be borne in mind. First, while such partnerships represent new modalities for stimulating rural economic growth, as per its mandate,<sup>15</sup> IFAD will continue working mainly through the public sector. Catalysing private-sector investment is a complement to, and is supported by, public sector expenditure; it does not replace it. Second, in all its forms, partnership with the private sector should be based on the principle of due diligence, whereby the assessment of risks and opportunities associated with engaging in a given private-sector partnership encompasses, on the one hand, partner selection based on an understanding of its governance and social accountability and, on the other, analysis of the product and/or service market to be developed. The basic principle for partnership with the private sector is that it should be fully consistent with IFAD's mandate and role and fulfil IFAD's mission of enabling the rural poor to overcome their poverty, while also enabling the private-sector partner to achieve its own corporate goals. Potential for partnership with the private sector in programme-related activities should be reviewed and assessed on a case-by-case basis, as is done in other organizations. This requires flexible policies and an open mind for innovation.

<sup>15</sup> As per the Agreement Establishing IFAD, the Fund can only lend to sovereign governments. This means that: IFAD cannot legally provide loan-funds to private-sector entities directly, and sovereign governments must be willing to on-lend loan funds to private-sector partners.

Kaoka undertook a market analysis of the cocoa supply chain, which showed that Sao Tome and Principe was well positioned for the production of aromatic organic cocoa. Based on the study findings, a three-year pilot was launched for aromatic cocoa production, with Kaoka providing technical assistance and guidance on how to improve cocoa production and strengthen the aromatic organic cocoa supply chain. The pilot phase has now ended, and Kaoka is ready to contract directly with smallholder farmers, who have recently created an aromatic organic cocoa exporters' cooperative. The contract would fulfil the profit objectives of both the small farmers and Kaoka: the small farmers would obtain a stable and higher income, building on the aromatic and organic qualities of their cocoa,\*\* while Kaoka would be guaranteed a stable quantity of organic cocoa of superior quality.

\* Cocoa is the major product on smallholder lands and represents 90 per cent of the country's exports.

\*\* At the current international cocoa price, small farmers could earn 2.4 times more by selling to Kaoka than by selling fresh cocoa on the local market.





# 7

## IMPLEMENTATION REQUIREMENTS

In order to effectively implement the PSDP strategy as laid-out above, IFAD will have to revise its operating model and internal processes. This will include the following:

### **Mainstreaming the strategy into IFAD**

**operations.** Once the strategy is approved, it will need to be mainstreamed into IFAD's operations and internalized by its staff. On the basis of the measurable objectives and outputs provided in the results framework, each IFAD unit or division will have to identify the activities that will be undertaken to achieve the common objectives, and include these activities in their annual workplan and budget. The divisional planned activities will then be aggregated at the departmental level, for a consolidated workplan and budget that is consistent with the overall objectives and outputs of the PSDP strategy.

As discussed above, IFAD reports, such as COSOPs and project design documents (when appropriate), will include an assessment of private-sector development in rural areas and will reflect partnerships and engagement possibilities with the private sector. Legal and financial procedures related to partnering with the private sector will also be developed and internalized within IFAD. Similarly, IFAD's portfolio review and its results and impact management system (RIMS) indicators will include reporting on IFAD's engagement with the private sector (see Measuring results and impact).

### **Guidelines, staff training and staff**

**realignment.** IFAD will develop guidelines (or a tool kit) for IFAD operations staff, to assist them in operationalizing the strategy. In fact, a draft operational manual entitled *Private-Sector Development and Partnership Manual* is in the process of being finalized with the support of IMI funds. The manual states that it: "currently consists of guidelines on partnerships with the private sector at the corporate level, in conformity with UN standards, and guidelines and tools for country-level private-sector engagement".

It is also important for IFAD staff to have a common understanding of how the PSDP strategy ties in with IFAD's mission and how to manage it in their programmes. Therefore, IFAD will provide training to its staff on how to partner with or engage the private sector in their operational work. This would include guidance in areas such as: approaches and processes for consulting with private-sector players (national and local) in order to identify the need for and barriers to further private-sector growth; techniques for the analysis of potential private-sector partners; procedures for the development of concrete partnerships (both financial and non-financial); and means to measure the results and impacts of these initiatives.

An IFAD staff member in the Programme Management Department will be appointed as the focal point for the private sector. The staff member will be responsible for providing support to his/her colleagues on issues related to linking to the private sector, following up on the operational implementation of the strategy, preparing progress reports, and monitoring and evaluating performance.<sup>16</sup>

**Measuring results and impact.** The proposed medium-term time frame for achieving the objectives and outputs of the PSDP strategy, as outlined in the annex, is from 2005 to 2008. Therefore, a gradual implementation will be undertaken, with a view to reaching all targets by the end of 2008. Given that the extent of private-sector development may vary among subsectors and among regions, and that the interest of private-sector partners may be stronger for certain countries or subsectors, each individual division will not be asked to achieve all targets in all areas. Instead, and at least in this initial phase of the strategy, IFAD will measure its performance at the aggregate level, with a view to gradually redressing subsectoral and regional imbalances.

An important part of implementing and operationalizing the strategy will be the development of ways and means to measure its results and impact. IFAD's RIMS and

<sup>16</sup> Another focal point, located in the Resource Mobilization Unit, will be responsible for mobilizing resources from the private sector for IFAD corporate activities. However, as noted in footnote 13, this resource mobilization function will require a resource mobilization strategy, which is separate from the one being discussed in this paper.

related monitoring and reporting tools will be expanded or revised to capture key indicators related to PSDP. IFAD presently has six impact domains within the existing evaluation framework: physical and financial assets; human assets; social capital and people's empowerment; food security (production, income and consumption); environment and common resources; and institutions, policies and regulatory framework. Most of these domains contain aspects that relate to the successful development of the private sector. It should therefore be possible to attribute specific and tangible benefits to smallholders or entrepreneurs that derive from efforts to partner with private-sector actors within a project. The PSDP strategy will be monitored through the RIMS and through the Progress Report on the Project Portfolio, presented annually to the Executive Board.

#### **Capturing, reporting and sharing lessons**

**learned.** As an issue related to measuring results and impact, it is crucial to analyse and document what works and what does not in IFAD's approach to PSDP. IFAD will need to learn from its successes and mistakes. This includes identifying the factors behind successful or unsuccessful PSDP initiatives. Drawing lessons from ongoing experiences and sharing these within IFAD and with other development partners will allow IFAD to improve its way of working with the private sector and enhance the impact of its operations on the rural poor. Capturing the lessons learned should be a continuous activity, with stocktaking conducted every few years to assess whether IFAD is moving in the right direction or whether there is a need to change direction or fine-tune the strategy and/or its operational guidelines. It is proposed that an evaluation of the PSDP strategy be undertaken by the Office of Evaluation at the end of 2008.

# PRIVATE-SECTOR DEVELOPMENT AND PARTNERSHIP STRATEGY

## RESULTS FRAMEWORK 2005-2008

### Narrative summary

### Key (performance) indicators

**Goal:** Increase growth and reduce poverty in rural areas through increased private-sector activities

- Households with improvement in household asset ownership index
- Number of private-sector jobs generated in rural areas

**Objective:** Increased pro-poor private-sector operations and investment in rural areas

- Flow of local private-sector investment in rural areas
- Number of rural enterprises established/strengthened
- Percentage of farmers using private advisory services
- Percentage of rural poor accessing private financial services
- Number of functioning marketing, storage and/or processing facilities

#### Outputs:

1. Enabling policy and institutional environment for local private-sector development provided

- COSOPs include strategy to engage in policy dialogue for local private-sector development
- Stakeholders in COSOP consultations include private-sector representatives
- Where appropriate, policy dialogue to support the local private sector is included as a country programme activity

2. Local private-sector development supported through IFAD investment operations:

- Strengthened **business capacity** of the rural poor and their organizations
- **Private technical/advisory services** provided to the rural poor
- **Private** RFIs strengthened to reach out to the rural poor
- **Private agricultural markets and SMEs** supported and linked to the rural poor

- 20-25 per cent of all new IFAD projects strengthen the business capacities and skills of targeted rural poor or their organizations (e.g. farmers' associations, savings and credit associations, and water users' associations)
- In new projects with a component for agricultural production and related advisory services, 25-50 per cent of such services would be delivered by private-sector providers
- In new projects with a rural financial service component, 50-75 per cent of the RFIs supported, strengthened or scaled up will be private-sector institutions
- 20-25 per cent of all projects will link small farmers with private markets or intermediaries (including contract farming initiatives) or will support the development of SMEs

3. **Partnerships** with the private sector established within the context of projects and programmes

- All new COSOPs include partnership possibilities with the private sector
- At least 15 per cent of IFAD projects will cofinance with or will generate complementary investments from the private sector



**Monitoring and evaluation mechanisms**

- Revised RIMS indicators

- Statistics on private investments and flow of funds  
(International Monetary Fund, World Bank, UN databases)
- Revised RIMS indicators

- COSOP documents
- Project design documents
- Revised RIMS indicators
- Portfolio reviews
- Evaluation reports
- Project completion reports

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- Resource mobilization unit reports on resource mobilization

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Enabling the rural poor to overcome poverty

