Southern Agricultural Growth Corridor of Tanzania

Appendix II:

The SAGCOT Partnership and Financing Mechanisms

Draft

Background

This document sets out the organizational structure and relationship between the SAGCOT Secretariat (under a newly established Tanzania Agricultural Growth Trust (TAGT)) and a newly established and independent Kilimo Kwanza Catalytic Fund (KKCF). It also sets out the proposed legal and governance structures. Finally, it describes the financial and information flows between the legal entities and with the funding partners, which potentially include Government of Tanzania and/ or development partners. Subject to approval by the Executive Committee, the structure will be used as a basis for seeking initial funding partners to support the early implementation of SAGCOT.

The Partnership

The main objective of the SAGCOT Partnership is to stimulate a major revival of agriculture in the southern corridor of Tanzania and the wider region served by road and rail links through to the port of Dar es Salaam and markets to the west. This will be achieved through a combination of:

- identifying and catalysing the deployment of new private and public sector funding into the Corridor to stimulate agribusiness growth including active development of the role of smallholder farmers;
- supporting the development of agribusiness "clusters" with new infrastructure development linked to the established infrastructure backbone;
- improving efficiencies of relevant and profitable agricultural value chains by, for example, stimulating more effective coordination and alignment of existing and/or planned hard and soft infrastructure programmes with the needs of commercial agribusiness; and

The SAGCOT Secretariat

There is no structure to link flows of investment, technology and progress within one set of agreed objectives. Working within the Kilimo Kwanza framework, these sets of functions provide the institutional 'glue' to bind the harder, more obvious, elements of the agricultural development process. These are actions and services that neither public nor private sector organisations can provide on their own. The structure of the partnership and its aims require the functions of an independent Secretariat to enable this to happen.

A truly neutral, non-aligned institutional framework is essential to ensure that the coordination platform that oversees and facilitates the partnership can operate in a totally independent manner. This will ensure that not only is it institutionally independent, but that it is perceived to be so by all partners.

The SAGCOT Partnership will assign responsibility for day-to-day coordination and facilitation activities to a SAGCOT Secretariat. The SAGCOT Secretariat is modeled, in part, on the experience of the Tanzania Agricultural Partnership (TAP).

The Secretariat will help to coordinate public and private sector partners' plans for the Southern Corridor, so they communicate, cooperate and link better together. It will also connect, through TAP, field implementation by creating an environment of improved trust, better communication and clearer information.

Amongst the Secretariat's responsibilities will be to mobilise a range of funds specifically targeted at SAGCOT. The SAGCOT Secretariat would engage with a range of possible funding facilities. For example, targeted funds would include a specific SAGCOT Catalytic Fund, a possible Africa Enterprise Challenge Fund Corridor (AECF) "Window" and a Patient Capital Fund (see below). It would also help coordinate broader-based funding that would include donor funds (such as through the Governments ASDP), grants, outgrower development funds, and debt and equity facilities that are available for use within Tanzania. The aim would be to provide access to finance for different agribusiness activities along specific agricultural value chains.

The Tanzania Agriculture Partnership

TAP was established in 2005 with initial support from Norad and latterly also from the European Commission. It provides support to the agricultural sector in its aims of stimulating a Tanzanian Green Revolution. It does this by a) coordinating the activities of partners around specific agricultural value chains, b) identifying and coordinating different financing facilities to support specific commodity value chains, c) generating objective and informed debate and discussion on agricultural issues, d) bringing in additional private sector investors and public sector organisations into the partnership, e) disseminating reliable and relevant information and knowledge

TAP now works in 25 districts and is shortly to expand into an additional 25 Districts. This public-private partnership has developed an informal group at national and district levels that work together to improve agricultural production and marketing.

The key lessons to emerge from the TAP coordination and facilitation activities include: (i) the strength of shared objectives to cover commercial and developmental goals, (ii) the value of an impartial, competent sectoral 'neutral' platform to bring different actors together, (iii) the need to improve trust and communication, (iv) the importance of focusing on specific commodity value chains, including inputs, agronomy, crop storage, marketing and finance, (v) the need to establish clear benefits for partner organisations to cooperate, (vi) clearly defined roles and responsibilities, (vii) the essential role of sharing information, (viii) the need to manage expectation, and (ix) the value of taking a few well-calculated risks to stimulate business as **un**usual .

TAP has developed a process for establishing district Commodity Investment Plans (CIP) that bring together local government authorities, farmers and agri-business in focusing effort and investment in a specific, locally important commodity. This is proving a useful tool in stimulating agricultural commercial development at the district level, as well as a vehicle for accessing additional support, *via* the District Agricultural Development Plans, from the Agricultural Sector Development Programme.

The Tanzania Agricultural Growth Trust (TAGT)

An institutional framework for the SAGCOT Secretariat, and TAP is required. Furthermore, other programmes, are seeking to align to the Partnership and therefore a broader coordinating body would seem to be the most favorable structure. Finally, other Agricultural Growth Corridors (AGC), and perhaps similar initiatives in fisheries and forestry to be developed in the future, can become part of this broader institutional framework. Each AGC will have its own characteristics, but will also benefit from the institutional anchorage, gained from the experience of being aligned under the framework and opportunities to share lessons learnt.

Under this structure, the SAGCOT Secretariat will become part of the Tanzania Agricultural Growth Trust (TAGT). The TAGT will be responsible for oversight and coordination of partnership activities. Its role will be to ensure that agreements entered into between the

funders and the different Coordination Units (for example, SAGCOT Secretariat and TAP Unit) and the separate KKCF are complied with.[1]

The Deed of Trust of the TAGT will be agreed with the current funders (of SAGCOT and TAP) and will be in accordance with the principles set out in the SAGCOT Secretariat Concept Note and the Catalytic Fund Concept Note. TAGT will be established as a Tanzanian legal entity subject to tax advice.

TAGT will also have partnership promotion and oversight roles, which will liberate the operational units (for the moment SAGCOT and TAP) to focus on field-based activities.

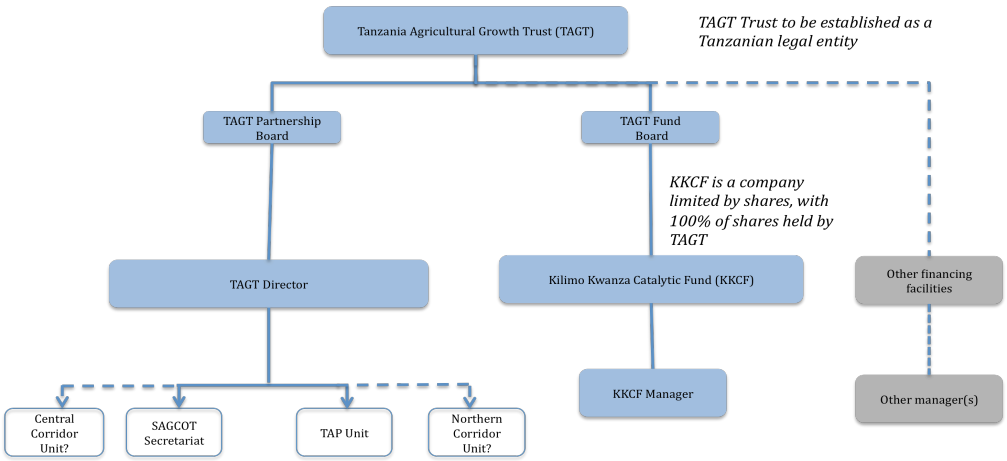
The Tanzania Agricultural Growth Trust would have an autonomous legal status in order for it to conduct its own affairs independently. In particular, it must be able to source and receive funds from the public and private sector to support its work in developing SAGCOT, TAP operations, establishing the KKCF, and servicing other partnerships and growth corridors that will develop in time.

The development of TAGT and the establishment of a TAGT Board will logically build on the existing structures and participants of the SAGCOT team and the Kilimo Kwanza Executive Committee.

TAGT will be incorporated under the Trustees' Incorporation Act based on the Ordinance of 25th May 1956. Resources received by such a trust (including income from paid assignments, grants and awards) would be used to support operations. It would have a Board of Trustees.

The TAGT will appoint a TAGT Director who will have overall responsibility for overseeing of the partnerships (both TAP and SAGCOT) and promoting private sector-led agricultural growth and partnerships.

Figure 1: The Tanzania Agricultural Growth Trust (Legal Structure)



[1] For the avoidance of doubt TAGT will not have decision-making or managerial responsibilities in relation to the activities of the KKCF. It will exist to provide assurance that those subsidiaries act in accordance with agreements reached with the funders.

TAP and SAGCOT

SAGCOT and TAP are closely related, and there is considerable complimentarity. But there are also significant differences of focus, priority and operations. TAP and SAGCOT have similar approaches but there are significant differences in some field operations and target areas. It is therefore important that they operate independently, though in the cluster areas there will be considerable cooperation between the two. They are better left independent both in terms of funding and management, especially as TAP operates in many areas outside of SAGCOT.

TAP's focus is currently on activities supporting district-level value chain operations, primarily through Commodity Investment Plans and follow-up support[2]. Additional activities offer support to value chain development. In addition, TAP funding for local 'hard investment' – such as renovating warehouses and crop demonstrations – fills current funding gaps in field activities. This is important both in providing necessary financial support for a critical value chain link and as a practical way of demonstrating TAP's effectiveness.

The SAGCOT secretariat will have a narrower remit, focusing on the corridor (and a fewer number of districts). The activities will also be different and will be determined by the partners. The main differences will be the coordination and development of commercial agriculture that can be taken to scale, the use of a Catalytic Fund (and other financial instruments) specifically for the Clusters/corridor, M&E for partners involved in the clusters, and coordination and facilitation of partners interested specifically on larger scale commercial agriculture within the corridor.

Access to Finance

SAGCOT aims to "kick start" socially responsible investment in commercial agriculture in the southern Corridor. The Partnership and the coordinating role of the secretariat are seen as a credible approach to mobilizing investment resources in a way that can create income-earning opportunities for smallholder farmers and local communities. This requires that SAGCOT moves rapidly from the design to the implementation phase and achieves early results. It is vital there is demonstrable progress on the ground – and that means a combination of public and private investment into viable new projects

A major activity of the Secretariat will therefore be to identify and help in the coordination and facilitation of financing facilities made available to commercial agribusiness. The type and range of these facilities is described in figure 2. The diagram represents the sequencing of different types of public and private finance that could be mobilized to support a medium-sized farming and processing business-requiring total funding of $15 million after 10 years. It shows how catalytic funding would be used to "kick start" private investment in sustainable and commercially viable projects with strong social benefits.

Furthermore SAGCOT would work closely with TAP to identify relevant donor funds that could be channeled through appropriate mechanisms[3] to help leverage additional finance.

[2] This will be complemented by targeted support to Rice and Maize value chain development in the 13 initial TAP districts funded by a European Commission Food Facility Grant.

[3] For example TAPs field programmes in leveraging donor funds to support smallholder linkages to commercial farming would be valuable here – TA has developed and field-tested district-level Commodity Investment Plans (CIPs). The CIPs would be targeted to specific commodities being developed by larger scale commercial

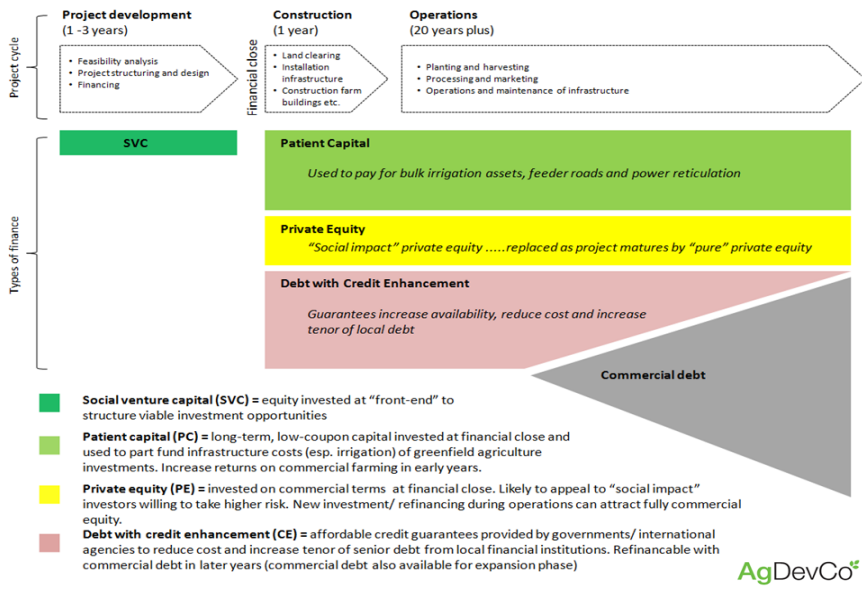


Figure 2: Financing Facilities available to SAGCOT

SAGCOT Financing Mechanisms

Three types of innovative financing mechanism are needed to support the implementation of SAGCOT. They are:

1. A **catalytic fund** (CF) to provide ***social venture capital*** (i.e. low cost debt and equity) to start-up agriculture businesses
2. A **patient capital fund** to provide long-term, subordinated debt to fund agriculture-supporting infrastructure (e.g. irrigation systems)
3. A **credit enhancement facility** to increase access and reduce the cost of borrowing from local banking institutions

Catalytic Fund (CF)

The CF (or Social venture Capital) is critical to ensure SAGCOT is a success. It complements other financing initiatives underway in the agriculture sector in Tanzania including the Agriculture Development Bank, NMB/AGRA's joint Innovative Financing for Agro-Dealer Network, Standard Bank/AGRA's Loan Guarantee Facility and the African Enterprise Challenge Fund (AECF). The CF will provide a pipeline of investable opportunities for private debt and equity investors. Development partners who have expressed interest in supporting the CF include DFID, USAID and the Norwegian Embassy in Tanzania.

The CF is facility which provides early-stage "social venture capital" to address the upfront costs of developing and starting up commercially-viable agriculture businesses in the Southern corridor. Funding would be awarded with strict conditions around developing smallholder and community benefits and establishing a robust reporting framework. All farming and agribusiness projects would be structured so that commercial third party

agribusiness in the clusters. The CIP planning process would help local farming communities not only link and develop into new larger scale commercial models, but also could be used to leverage additional funds (over and above catalytic and patient capital) from the public sector such as ASDP to support the programmes.

finance could be brought in as soon as the project was viable and acceptable to the local financial sector.

Social venture capital is used for the identification and early-stage development of small and medium sized (SME) agribusinesses, especially those involving primary production and with direct links to smallholder farmers. The project development phase – which can take 12-18 months to complete – culminates in the preparation of an investment memorandum that is then used to secure equity and debt from third parties to fund the business plan including the smallholder development proposals.

All investments made by the CF would be repayable at the point where the project attracts third-party private investment (i.e. there is no intention of providing subsidies to private businesses). The proceeds would then be recycled into developing new projects in the corridor.

A proposed technical assistance facility associated with the CF would provide grant funds to support smallholder / emergent farmers and associations to develop and submit high quality applications to the CF. The TA facility could be managed by the TAP/ SAGCOT Secretariat.

The catalytic fund would be a donor-backed revolving fund, used exclusively to target agriculture/agribusiness. The CF will be designed to provide subordinated and mezzanine debt to early-stage agribusinesses. Repayments will be made from the beneficiary companies back into the fund as soon as they are able to refinance the debt with investment from incoming third-party investors. The CF will then use those reflows to invest in new projects (i.e. it is a revolving fund). The CF will provide funding amounts typically in the range of $200,000 to $2,000,000. The CF will also provide short-term funding to help a company get to the stage where it can attract third-party finance.

Patient Capital (PC)

Patient capital is subordinated (long term) debt that is used to finance "agriculture-supporting infrastructure" at a low fixed coupon (e.g. 5% per annum). It can finance small dams, bulk water distribution systems, feeder roads and storage facilities. These are long-term assets with semi-public good characteristics that cannot be financed on fully commercial terms. However, they can pay a return over 10 – 15 years and do not require public grant funding.

Government and/ or development partners could provide patient capital. It may be possible to "blend" in commercial finance from the private sector (e.g. pension funds) paying a higher coupon if government/ development partners were prepared to accept a lower financial return. Patient capital would be disbursed through an independent Trust[4] managed by a professional staff on behalf of the funding partners. The Emerging Africa Infrastructure Fund (EAIF) provides an example of a successful precedent (in the African infrastructure sector) for this type of donor-backed debt facility. Lessons on governance/ management arrangements can also be drawn from the Africa Enterprise Challenge Fund (AECF).

A facility of $100 million could leverage in a further $500 million of commercial debt and equity into early-stage farming and processing businesses in the southern corridor of

[4] It is proposed that this entity should be independent but aligned to the proposed Tanzania Agricultural Growth Trust (see below)

Tanzania. More analysis on the financing requirements will be presented in the SAGCOT Investment Blueprint.

Credit Enhancement (CE) facility

Commercial bank lending to early-stage agriculture businesses in Africa is very limited – less than 1% of loan books. Credit Enhancement (or guarantee) facilities are provided by the public sector to encourage commercial bank lending by reducing the size of the financial loss in a potential downside scenario. Banks share in the downside risk (through a risk sharing agreement with the donor providing the credit guarantee) with the guarantees only being awarded to projects that demonstrate financial viability.

There are a number of existing credit guarantee institutions in Africa and Tanzania which provide partial credit guarantees. The largest and most successful facilities such as USAID's Development Credit Authority (DCA) programme and GuarantCo (part of the Private Infrastructure Development Group) currently focus primarily on infrastructure sector. Tanzania's PASS programme has a successful track record of leveraging local commercial bank lending for agriculture businesses by providing credit guarantees.

For SAGCOT, further consideration will need to be given about whether to establish a new facility or - as may be preferable – set up dedicated windows within one or more existing facilities (e.g. the DCA programme) with a local implementation capacity (e.g. working with PASS).

Initial Funding of the Facilities

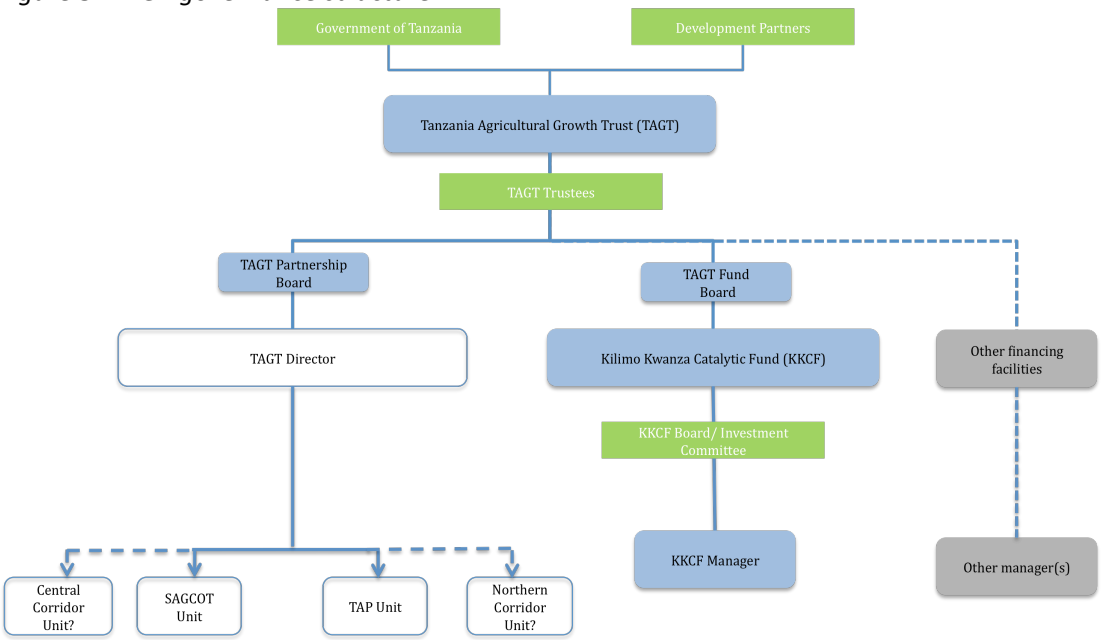
A $75 - $100 million facility is considered the minimum to support the full implementation of SAGCOT. Given the extent of funding that will be required to develop the SAGCOT and its clusters, this amount should be seen as a starting point. This would be a pilot or initial funding phase. Of the $ 75 million the indicative proportions for the three facilities would be approximately:

- Catalytic fund - $15 million
- Patient capital fund - $35 million
- Credit guarantee facility - $25 million

Governance and reporting structure

The TAGT governance and reporting structure is summarised below (Figure 3). The Board of Trustees will have responsibility for upholding the terms of the Deed of Trust and the provisions of funders' agreements. The trustees will be nominated by the funders. The Board of Trustees will appoint the Managing Director of the Partnership, on the recommendation of funders. The board of Trustees will also appoint the board of the KKCF on the recommendation of the funders. Responsibility for decision-making and management of the SAGCOT and TAP Units shall rest with the Managing Director of the Partnership and, separately, responsibility for decision-making and management of KKCF shall rest with the board of KKCF. The membership of the KKCF investment committee shall be made up of the members of the KKCF board (or a qualified alternate) and several independent committee members to be nominated by the funders. All investment committee members shall be qualified to make assessments of the commercial viability and developmental impact of agricultural investments.

Figure 3: TAGT governance structure



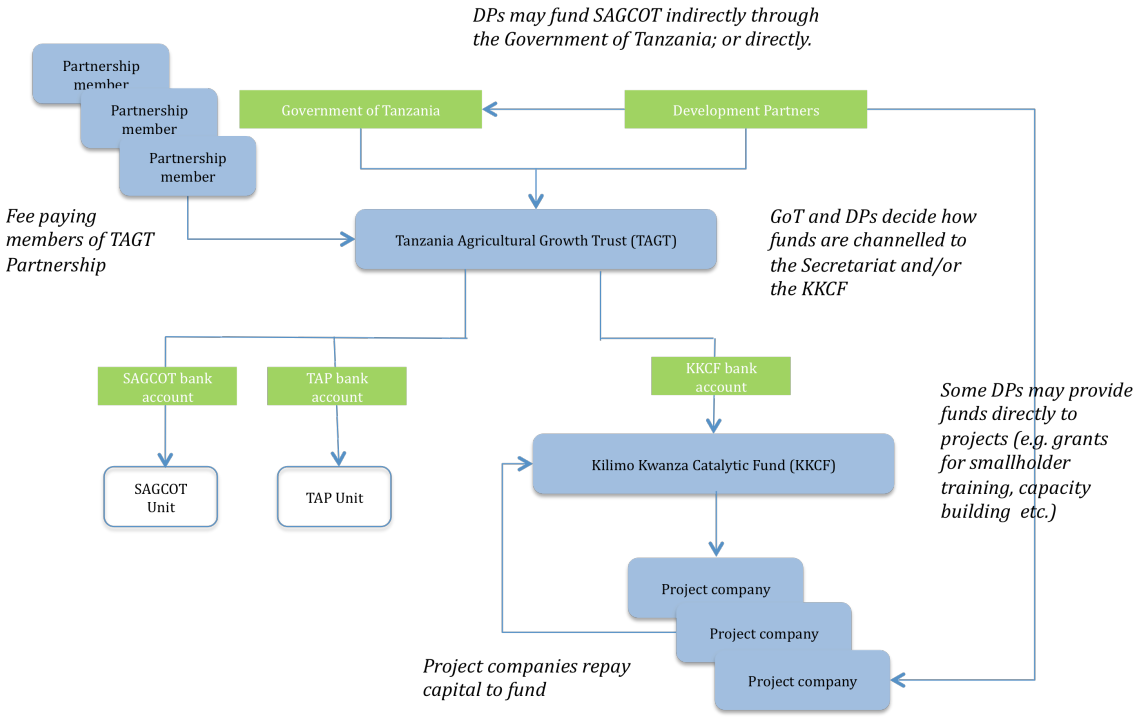
The TAGT Trustees with the TAGT Director will agree an annual operating plan and budget and will be responsible for overseeing the performance of the TAP and SAGCOT Units and ensuring satisfactory implementation of the agreed plan and budget. All decisions taken by the TAGT Trustees shall be consistent with the purpose and objectives set out in funding agreements. For the KKCF, all investment decisions will be made by the KKCF board on the advice of the Investment Committee in accordance with the Operating Policies and Procedures (OPPs) approved by the funders. It is proposed the OPPs will be consistent with the principles outlines in Annex 1. In terms of information flows, the Managing Director of the Partnership and the KKCF investment committee will report to the funders through the TAGT Board of Trustees.

Flow of funds

Funds would be provided to the TAGT by funders for onward disbursement to the SAGCOT and TAP Secretariats and separately to the KKCF, for use by them in accordance with the terms of the agreed funders' agreements. Development Partners (DPs) may fund TAGT directly, or through the Government of Tanzania. Separate dedicated bank accounts would be established for the entities. The SAGCOT Technical Team sought legal advice towards the structure. The opinion was to simplify the structure to have the Partnership established within the TAGT (which has been done). Separation has been maintained between the TAGT and the KKCF to enable independent governance and decision-making.

Separate tax advice will be sought after endorsement to the structure as to whether the bank accounts should be established on-shore or off-shore.

Figure 4: TAGT flows of funds



Interim arrangements will be established for the rapid implementation of the the KKCF while the TAGT structure and Managing Director of the Partnership are being put in place. For the Partnership (TAP and SAGCOT), funds could be provided through the Agricultural Council of Tanzania (as per arrangements for the SAGCOT Investment Blueprint development). For the KKCF, funds could be held by a reputable international or Tanzanian company with specific contractual agreements on the use of funds.

Interaction with TAGT and the SAGCOT Secretariat

The KK investment committee will make investment decisions. However, the KK Investment Committee will work closely with TAGT and the SAGCOT Secretariat as well as other local agricultural support organisations, which are active in the area. The role of the TAGT will be to promote the KK Fund to its members and encourage funding requests to be made directly to the Fund Manager. The SAGCOT secretariat will also help identify suitable strategic and investment partners who can contribute to the long-term success of the projects developed by the Fund and in particular help to leverage donor funds towards Cluster development.

The SAGCOT Secretariat will also provide monitoring and evaluation services to ensure that smallholder benefits are being realised. Through its work with local government Agencies (LGAs) and other local district officials the SAGCOT Secretariat will also be able to provide valuable on the ground presence and help in the facilitation with local entities. Furthermore, with its work on the development and implementation of value chain support programmes, such as local Commodity Investment Plans, TAP will be able to work with the SAGCOT Secretariat to support smallholder linkages with larger commercial farming and help develop sustainable and profitable outgrower and other contract-type farming schemes. Finally, the SAGCOT secretariat will help facilitate and coordinate additional activities and investments that lie outside that immediate investment focus of the KK Fund Manager but which are important to provide the correct enabling environment to create sustainable agribusinesses and develop the scale needed to boost efficiencies in commodity value chains.

Annex 1: Principles governing the Kilimo Kwanza catalytic fund

1. Principles governing the type of investments to be made by the fund:

i) *Commercial viability:* To ensure long-term sustainability, all projects must be commercially-viable agribusinesses which show potential to attract private debt and equity finance once properly developed. Funding recipients should have a credible operating capability.

ii) *Development impact:* All agribusinesses supported by the fund must involve significant benefits for local communities and smallholder and emergent farmers, including improved infrastructure provision (e.g. irrigation/ storage/ processing). Agribusinesses must comply with internationally accepted social and environmental standards; they should also promote gender equality.

iii) *Additionality:* All agribusinesses should be greenfield or early-stage enterprises which are currently unable to access other types of finance. The CF must not crowd-out other investors, but should instead seek to leverage third-party finance from local and international investors into the agribusiness as soon as possible

iv) *No subsidy:* Funding should only be awarded where there is a sound economic justification in terms of "market failure" (e.g. inefficient capital markets, lack of public infrastructure, barriers to entry, economies of scale). CF funding should be withdrawn as soon as an agribusiness is able to attract private investment.

v) *Monitoring & evaluation:* All agribusinesses will have monitoring and evaluation (M&E) indicators which will be used to track performance against targets throughout the life of the project. The SAGCOT Secretariat will have responsibility for collecting and disseminating M&E data.

2. Principles governing the investment decision-making process:

i) The fund manager should recommend projects to an independent board/ investment committee comprising non-executive directors and other qualified nominees of the funders. Investment decisions are made by the board/ investment committee.

ii) The CF board / investment committee should have an absolute duty to uphold the operating policies and procedures of the fund and ensure the investment principles are complied with. It should report to the SAGCOT board or such other board as acceptable to the funders.

iii) The majority of individuals on the board/ investment committee should have a background in the private sector with experience of investing in agriculture and related businesses in Africa and/or other relevant fund management decision making in the private sector.

iv) The board/ investment committee should have no financial interest in the success or failure of any of the projects to be supported by the fund.

v) Typical investments made by the fund will be in the range $200,000 to $2,000,000, although larger investments may be made in exceptional cases where there are exceptional development benefits underpinned by a robust commercially-viable business plan.

3. Principles governing the appointment of the manager of the fund:

i) The manager of the fund should have relevant skills and experience in developing early-stage agribusinesses in Africa and raising commercial finance for them. The manager should also have experience of working with smallholder farmers.

ii) The manager should have a local presence in the region (or the ability to quickly establish such a presence) and a proven ability to work on the ground alongside entrepreneurs and smallholder farmer organisations to develop and finance early-stage agribusiness projects.

iii) The manager should have a network of relevant contacts in Tanzania, the region and internationally and should be seen as a trusted and respected agribusiness project developer by stakeholders including entrepreneurs, financiers and governments.

iv) The manager should be willing to work closely with the SAGCOT Secretariat to help identify investment opportunities and raise third-party support for them form a range of stakeholder including government, development partners and the private sector.

4. Principles governing fees and incentives for the fund manager:

i) The manager of the fund should operate within a framework where rewards are directly linked to successful delivery of the objectives set by the funders, specifically to successful mobilisation of private capital into agribusinesses which accord with the principles set out above.