Pilot Program for Climate Resilience Program Approval Request **PUBLIC VERSION**				
1. **Country/Region:**	*Bangladesh*		2. **CIF Project ID#:**	(Trustee will assign ID)
3. **Source of Funding:**	☐ FIP	■ PPCR	☐ SREP	
4. **Project/Program Title:**	*Climate Smart SME Financing*			
5. **Type of CIF Investment:**	☐ Public	■ Private	☐ Mixed	
6. **Funding Request in million USD equivalent:**	*Grant: n/a*	*Non-Grant: USD 10 million*		
7. **Implementing MDB(s):**	*IFC*			
8. **National Implementing Agency:**	*Private sector*			
9. **MDB Focal Point and Project/Program Task Team Leader (TTL):**	*Headquarters- PPCR Focal Point:* *Joyita Mukherjee (jmukherjee1@ifc.org)* *Laura Gaensly (lgaensly@ifc.org)*	*TTL:* *Arsalan Alfred Ming Dode Ni (ANi@ifc.org)* *Haruhisa Ohtsuka (HOhtsuka@ifc.org)*		
10. **Program Description (including objectives and expected outcomes):**				

1. Program Description:

This Program Proposal corresponds to the investment component of the IFC-managed PPCR Program for Bangladesh, "*Promoting Climate Resilient Agriculture and Food Security*" as listed in Bangladesh's SPCR, endorsed by the PPCR Subcommittee in November 2010.

The IFC-managed PPCR Program has an advisory services component (grants) and an investment component (concessional finance). The advisory services component was approved by the PPCR Sub-Committee in August 2013 and it is currently under implementation. The advisory program is working with private sector companies to pilot climate-smart agricultural technologies and practices suitable for promoting climate resilient agriculture and improving farmer livelihood. At the time of the approval, IFC stated that twelve to eighteen months after commencement of the advisory program, IFC would submit a second Program Proposal for approval by the PPCR Sub-Committee detailing the investment component of the program (this proposal).

In preparation for the investment component, IFC has completed scoping and market studies, and consulted with key stakeholders including private sector agribusiness companies, local banks and financial institutions, government agencies, development partners and civil society associations. Through this engagement, a lack of access to finance (particularly for small and medium enterprises or SMEs) has been identified as one of the main barriers for the private sector to develop its capacity and adopt climate-smart technologies that can strengthen supply chains, and support recovery from natural disasters due to climate change.

The objective of this program (Climate Smart SME Financing) is to promote SME financing and enhance the capacity of SMEs working to develop and deliver climate-resilient inputs and climate-smart technologies that will ultimately increase resilience of poor communities in Bangladesh.

A context for the sector, the market barriers, and the proposed program are described below.

1. Context

The combination of frequent natural disasters, high population density (over 158 million people[1]), inadequate infrastructure and low resilience to natural and economic shocks, makes Bangladesh especially vulnerable to climate change (Bangladesh Climate Change Strategy and Action Plan[2]). The high incidence of poverty and heavy reliance of rural communities on agriculture and natural resources increases this vulnerability even more to the changes in climate. There is an urgent need to develop appropriate adaptive measures to build the coping capacity of communities and businesses to avoid catastrophic consequences to lives and livelihoods of millions of people.

The agriculture sector is a vital sector of Bangladesh's economy, accounting for about 20% of Gross Domestic Product (GDP), and employing 65% of the labor force. However, forecasts on climate change impacts indicate that increased flooding and rising sea levels will severely impact the sector. The industrial and manufacturing sectors are also essential contributors to Bangladesh's economy, accounting for about 30% and 17% of the GDP respectively (remaining 33% of GDP is from the service sector). Specific climate change threats to these sectors include potential damage to infrastructure and assets caused by erratic flooding, cyclones and storm, saline intrusion, and extreme temperature as well as drought and lack of access to critical natural resources (water, energy, forest, farmland, fisheries, etc.) required by businesses operate and grow.

Bangladesh needs investments in infrastructure (polders, dykes, cold-storage, climate-resilient housing, effective drainage, early warning systems, among others) as well as in climate-smart products and services that can help reduce climate risks and build adaptation capacity of its business and population, especially of rural and poor communities. These needs and demands present a number of opportunities for the private sector. Engagement of the private sector in climate adaptation in Bangladesh, however, is still nascent, but it could catalyze greater investments in vulnerability reduction that in turn will accelerate the adoption and replication of climate-resilient technologies and services in core sectors.

[1] The World Bank Open Data, 2014.
[2] Ministry of Environmental and Forests, Government of the People's Republic of Bangladesh, 2009

Ninety percent of private enterprises in Bangladesh are SMEs, and around 25% of the total labor force is employed by SMEs. Moreover, the SME sector contributed up to 25% of Bangladesh's GDP in 2013, and it is widely distributed geographically offering opportunities for economic improvement across the country. These SMEs create job and generate income for the low income segment of the population. SMEs are also critical for social development, social stability, and contribute to the development of a dynamic private sector. As such, it is very important that SMEs have access to capital and technical assistance to growth and become resilient to economic and climatic shocks. Recognizing the importance of the sector, the Bangladesh Bank (central bank) has undertaken a policy to increase lending for SMEs. Access to financial services by SMEs however remains severely constrained due to perceived higher risks by local banks, the weak outreach of public sector banks, and lack of availability of the appropriate lending models and risk management strategies. Few investors are willing to provide the much needed risk capital — particularly in the form of equity, necessary for early growth SMEs that offer innovative technologies or business models with high impact potential. Additionally, financing climate resilience is a new concept and it is difficult and more costly for private investors to identify and invest in climate adaptation.

There is an opportunity for financial institutions like private equity funds to meet this key gap in SME financing and address some of the above-mentioned challenges. Access to adequate financing can help local SMEs not only provide products and services that directly reduce climate risks but also create jobs and develop financial capacity for business and communities to cope with climatic stresses. The program aims to play a catalytic role in demonstrating what it takes to invest successfully in SMEs and build climate resilience. The program will leverage IFC’s extensive experience in investing in SMEs, and combine it with dedicated advisory services with a particular focus on supporting SMEs that are helping create climate resilience in Bangladesh as well as increase resilience of SMEs to respond to changes in climate.

Description of Market barriers:

Key barriers that need to be addressed to promote finance for SMEs that offer innovative services and technologies or business models to build climate resilience are:

1) *Unwillingness of financial institutions to lend and the private sector to invest in a novel topic (climate resilience) without a proven business model*: Even though financing SMEs is not a new concept, adding the dimension of climate adaptation is a relatively novel area of financing. Private sector investors lack the knowledge and expertise to identify climate resilience investment opportunities when making financing decisions. The additional costs and risks associated with being among the first movers to invest in unprecedented systems make it unattractive for the private sector.

2) *Limited financial products targeted at SMEs, especially risk capital or equity financing*: In Bangladesh, limited financing for SMEs have hindered SMEs’ ability to expand, create jobs and contribute to economic growth. Local financial institutions in general do not actively finance the SME sector, they prefer to concentrate their activities on small number of large firms. Private investors are not willing to

provide risk capital that is necessary for early growth SMEs that offer innovative technologies or business models with high impact potential. As a result, SMEs are almost fully dependent on either own sources of finance or on other informal sources.

3) *SMEs' minimal business skills, operational and financial reporting capacity, and lack of collateral:* There is a growing demand on local SMEs in Bangaldesh to improve management performance and to professionalize their operations in order to compete in a modernizing economy, compete with foreign-invested reivals, and to gain access to risk capital. However, the local market has not been able to meet SMEs need and demand for relevant high quality management and business training. Local SMEs lack skills and knowledge in operational and financial reporting, segregating commercial and personal transactions, market analysis and business plan preparation, and generating meaningful data for decision making. The absence of these necessary skills constrain the ability of SMEs to build financially viable businesses and limit their access to finance.

Objectives of the Climate Smart SME Financing Program

The investment component of the IFC-PPCR program will seek to promote SME financing. This program will invest in SMEs working in various sectors, including SMEs that are developing and delivering climate-resilient inputs and climate-smart technologies to poor communities to increase resilience to changes in climate. It aims to demonstrate that SME financing and climate-resilience finance can be profitable with the expectation that other investors will follow IFC's lead over time.

The Climate Smart SME Financing program will consist of an investment component (utilizing PPCR concessional finance) that will be complemented by advisory services to meet program objectives (financed by IFC's own resources and the existing IFC-PPCR advisory services program).

The specific objectives of the program are:

1. Increase access to finance (such as risk capital, etc.) for SMEs, especially those SMEs that are providing climate smart products or services that can increase climate resilience of businesses and poor communities.
2. Strengthen the capacity of select SMEs to cope with climate change (business sustainability) as well as to develop business skills to increase their capacity to grow and compete in the market.
3. Strengthen the capacity of fund managers and staff to identify climate resilience investment opportunities when considering financing for SMEs.

11. Consistency with Investment Criteria:

The program proposal is embedded in the broader context of sustainable development and poverty alleviation contexts as elaborated in Bangladesh's SPCR. The program aims to provide the much needed growth capital for the SME sector that accounts for 25% of Bangladesh's GDP and is critical for social and economic development in the country. The program aims also to demonstrate an innovative way to engage the private sector in adaptation, and help contribute to the country's resilience to climate change. The program will scale up and leverage private sector investments targeting SMEs to develop products and services that directly reduce climate risk, create jobs and develop capacity of business and communities to cope with climate change. The program will demonstrate that the market of SME financing and climate resilience business can be profitable with the expectation that other providers of finance will follow IFC's lead over time. Ultimately, the program will help increase resilience of rural farming and poor communities in Bangladesh that are vastly served and employed by SMEs.

12. Stakeholder Engagement

This program builds on the stakeholder engagement process that was conducted during the development of Bangladesh's SPCR. During the design phase of the PPCR program for Bangladesh, IFC carried out identification missions and discussions with private sector (agribusinesses, banks, funds, micro-credit institutions, and others), government agencies, sectors experts, and other development agencies, to identify key opportunities for our interventions.

13. Gender considerations

In Bangladesh women constitute almost half the population, but the presence of women in the SME sector is still very low. In emerging markets, while there are between 8 to 10 million formal women-owned SMEs (representing 31 to 38 percent of all SMEs in emerging markets), the average growth rate of women's enterprises is significantly lower than the average growth rate for SMEs run by men. A number of factors have been identified as contributing to the slow growth of women-owned businesses, including institutional and regulatory issues, lack of access to finance, relatively low rates of business education or work experience, risk aversion, confinement of women's businesses to slower growth sectors, and the burden of household management responsibilities. Both access to finance and access to market are repeatedly identified as major constraints to women entrepreneurs[3].

In addition, surveys have shown that it is not only the case that women entrepreneurs are less likely to have taken out a loan, but the terms of borrowing can also be less favorable for women. Women entrepreneurs are more likely to face higher interest rates, be required to collateralize a higher share of the loan, and have shorter-term loans. Women also lack access to markets, which increases the level of difficulty to grow their businesses. The IFC-PPCR program will address women entrepreneurs' needs in accessing finance by providing the same risk capital and access to markets to women-owned SME as well as to men-owned SMEs. The program will aim to reach out to women entrepreneurs and provide advisory services to their SMEs and capacitate them to cope with climate change. The program will also encourage SMEs to hire more women staff and to improve working environment for female employees.

[3] "Strengthening Access to Finance for Women-Owned SMEs in Developing Countries". IFC, October 2011.

14. **Indicators and Targets (consistent with results framework):**	
Core Indicator	**Target**
(a) Leverage of PPCR funding against private investments in climate sensitive sectors	- US$10 million in financing for SMEs.
(b) Quality and extent to which climate responsive investment models are developed and tested	- Up to 30-40 SMEs (including women led SMEs) benefiting from financial and advisory services from this program.
(c) New jobs created	- 500 new jobs created, of which 15% are women.
(d) Fund managers are trained on climate resilience and how to identify climate resilient investments.	- Training of at least one fund manager and its investment officers.
(e) SMEs are trained and receive advice on how to increase their capacity to cope with climate change and as well as to develop business skills to increase their capacity to growth and compete in the market.	- 30- 40 SMEs (including women led SMEs) are trained on climate resilience, business sustainability and business skills.

15. Budget		
Expenditures[4]	**Amount (USD) -** estimates	
PPCR Investment (this request)	10,000,000	
Total	**USD 10,0 00,000**	
Co-Financing[5]:	*Amount (USD million):*	*Type/Source of contribution:*
• IFC	12,000,000	Equity investment
• Private Sector	3,000,000	Other private investors
• IFC Advisory services to SMEs and fund managers and staff	200,000	IFC
Co-Financing Total	**Up to USD 15,200,000**	
TOTAL	**USD 25,200,000**	

16. Project/Program Timeframe
Expected Board/ MDB Management Approval Date: June 2015
17. Other

4 Expenditure categories should be provided by the MDBs based on own procedures.
5 This includes: in-kind contributions (monetary value), MDB loan or grant, parallel financing, etc.

Role of other Partners involved in project/program:
IFC will seek to involve other national and international partners (NGOs, community organizations, and other private sector entities) in the implementation of the advisory component of this program according to their specific expertise and program needs. The program will also coordinate with other donor agencies currently implementing related programs in Bangladesh, including JICA.

Implementation Arrangements (incl. procurement of goods and services)**:**
In terms of procurement of goods and services, World Bank Group procurement guidelines will be followed.