

**PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE**

Report No.: AB4800

Project Name	AF Rural Enterprise Development Program
Region	SOUTH ASIA
Sector	Crops (20%);Other social services (20%);Micro- and SME finance (20%);General agriculture, fishing and forestry sector (20%);Agricultural marketing and trade (20%)
Project ID	P110407
Borrower(s)	THE ISLAMIC REPUBLIC OF AFGHANISTAN
	Government of Afghanistan Afghanistan
Implementing Agency	Ministry of Rural Reconstruction & Development Darulaman Kabul, Afghanistan Tel: +93 799 174071 naser.temory@mrrd.gov.af
Environment Category	<input type="checkbox"/> A <input checked="" type="checkbox"/> B <input type="checkbox"/> C <input type="checkbox"/> FI <input type="checkbox"/> TBD
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Country and Sector Background

1. Over 75% of the people of Afghanistan live in rural areas where agriculture is the primary activity and contributes about half of the GDP (excluding the opium economy). However, poor governance, weak factor markets, inadequate marketing infrastructure and business development services, and poor post-harvest practices are limiting the economic development potential of this sector and restricting on-farm and non-farm employment opportunities; perpetuating poverty in the rural areas. The following are the key issues and challenges:

- (a) **Poverty and Vulnerability** remains widespread. According to data from the National Rural Vulnerability Assessment, almost half of the rural population had food expenditures less than that required to purchase adequate calories (2100 calories/person/day).
- (b) **Spread of Opium Poppy:** In conditions of lawlessness and impoverishment, the cultivation of opium poppy has become Afghanistan's leading economic activity, with the opium economy accounting for more than one-third of estimated total (drug-inclusive) GDP.
- (c) **Weak Institutions:** Unlike many other countries, the incentive structure for agriculture in Afghanistan is largely market driven and there are no major distortions arising from input subsidies, price support policies, or trade restrictions. The main challenge is weak institutional capacity. Both public and private institutions lack the physical infrastructure, necessary regulatory framework, and the skilled staff to build a modern and competitive agricultural sector.

- (d) **Poorly Functioning Factor Markets:** There is no formal rural financial system. Traditional sources (such as moneylenders, family, and friends) and NGO-led micro-finance initiatives under the Micro-Finance Support Facility of Afghanistan (MISFA) are currently the main sources of credit. Years of conflict have also disturbed tenure security, including farm and pasture rights and weakened the ability of administrators or courts to uphold rights fairly.
- (e) **Inadequate Marketing Infrastructure:** Constrains include poorly maintained road network, fears about security, inadequate market facilities (even lacking basic water, electricity, and sewage in many cases), telecommunications and support services like market information systems, food safety regulations, grades and standards, and quality control.

2. With regards the private sector, 'The Afghanistan Investment Climate in 2008' study done by the World Bank which though reporting strong revenue growth amongst the country's private companies, shows worryingly few new firms. The key issues identified by this study were poor governance, especially in terms of policy enforcement, crime and corruption, weak factor markets, particularly for access to land, finance and electricity, and an overall lack of innovation. Firms in Afghanistan produce primarily for the domestic market, with only 2% direct exporters but with another 5% operating as indirect exporters. Agribusinesses account for 28% of all business.

3. A census carried out in 2009 by the Afghanistan Rural Enterprise Development Program (AREDP) of over 1,708 Small and Medium Enterprises (SMEs) in 33 provinces identifies amongst others two major obstacles to private sector enterprise growth: a shortage of business expertise and weak access to formal credit. More than 60% of the SMEs surveyed indicated a need for knowledge-based business training support, in particular technical (40%), business management (37%), and financial management (20%). Over 96% of the enterprises expressed an interest in accessing financial services. Of the 1,708 SMEs, only 13% had ever applied for loans, while 7% had received a formal loan. Women owned firms are very limited (8% in AREDP census and 3% in the WB survey).

Objectives

4. The overall development objective of the proposed Program is to "improve employment, and income of men and women in the rural areas; and sustainability of targeted local enterprises." This will be achieved by enhancing participation of the rural poor in economic activities, supporting them through business development services and access to finance, and improving market linkages and value chains. The key outcome indicators to assess achievement of the Program Development Objective (PDO) will be as follows:

- (a) 70% of Enterprise Groups (EGs) will have increased their net revenues by over 50%. At least 35% of these will be female EGs;
- (b) At least 30% increase in direct and/or indirect employment by SMEs and EGs. At least 35% of those employed will be women;
- (c) On average SMEs report at least a 50% increase in purchase of inputs produced in rural areas;

- (d) 50% of supported EGs are still operating 2 years after start-up. At least 35% of these will be female EGs.

Rationale for Proposed Project

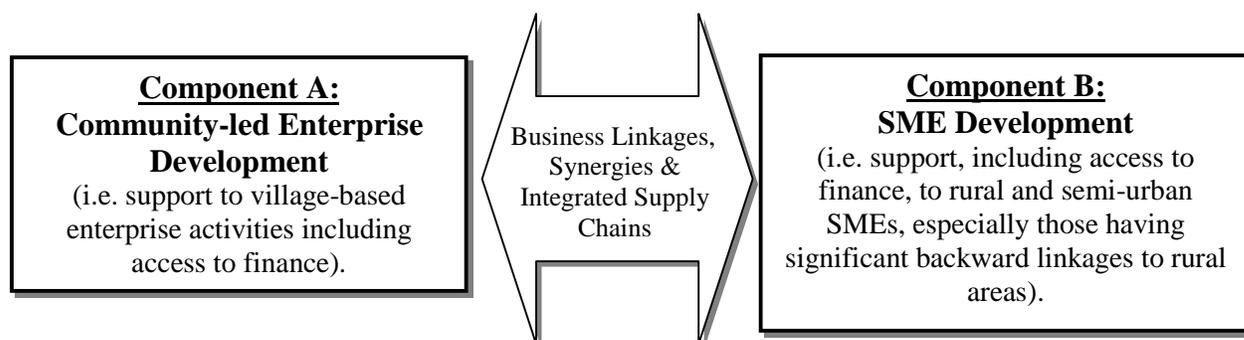
5. The World Development Report 2008, states “in the 21st century, agriculture continues to be a fundamental instrument for sustainable development and poverty reduction”. The report emphasizes the importance of agriculture as the lead sector for GDP growth, source of livelihoods and poverty reduction; food security and a better way of managing natural resources.

6. In the context of Afghanistan, a priority area in the World Bank’s current Interim Strategy Note (ISN) for Afghanistan is the promotion of growth of the rural economy and improvement of rural livelihoods. In this context MRRD has approached the World Bank to support the government-led AREDP to leverage group formation and capacity built under NSP. This is to improve the tangible income and employment opportunities through increased access to financial services and technical expertise. The ISN also endorses new types of support that will build on existing Bank programs to improve access to markets and services in rural areas, and employment creation in agriculture and non-farming sectors – which AREDP will respond to.

7. The program follows two of the four pillars of the Agriculture Action Plan FY10-12 (designed to operationalize the WDR) namely “linking farmers to markets” and “facilitating agriculture exit and entry and non-farm rural incomes.”

Description

8. A two-pronged approach has been designed for this Program¹:



The rationale for this approach is as follows:

9. In Afghanistan, most current value-chains are inefficient, with high transaction costs that make products uncompetitive even in domestic markets. Regional experience (India, Sri Lanka and Bangladesh) has demonstrated that promoting such synergies between private companies and rural enterprises are a powerful force for generating increases in rural income. The key benefits are lower transaction costs (e.g. aggregation to form sensible critical mass, the facilitation of more efficient logistics) and the mutual benefits for producers and buyers of market oriented production (e.g. introduction of improved
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technology, production & primary processing to buyers specifications). And in time these can develop into production contracts (mainly informal) and suppliers' credit. These mutual benefits can be achieved by creating linkages between reliable, rural producers (enterprise groups) of higher quality products and the semi-urban/rural SMEs.

10. NSP (especially its Human Capital Development (HCD) sub-projects which focus on women), and international and national NGOs (AKDN, DACAAR, Afghan Aid, Hand in Hand, etc) have supported the development of a range of skills and small enterprises in villages. In total some 8,000 groups of different types (e.g. Common Interest Groups, Enterprises, Farmer Association, Self Help Group) have been formed. The support has focused primarily on production issues. These groups will become a basis for further entrepreneurial activities within AREDP. Rural entrepreneurs are often unable to effectively market their products due to uneven quality, lack of knowledge of market demand and no market access. The Program aims to improve and 'marry' two critical players of the value chain, i.e. the producers on the one hand, and the buyers on the other, and allow production to be refined to match market demand.

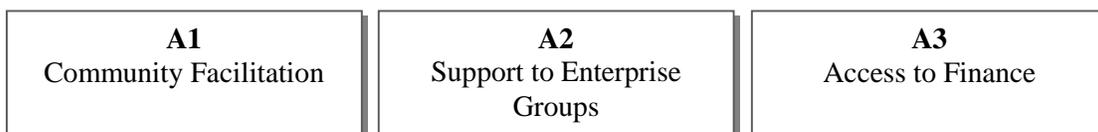
11. AREDP has already initiated a pilot project through a Project Preparation Facility (PPF) in June 2009 in Parwan province that validates the above approach. Villagers in the pilot clearly indicated their enthusiasm for support in developing commercial enterprises. At least in the first stage their primary need is for gaining expertise for starting and managing their chosen businesses². In most cases local expertise is available to provide these practical trainings, however not being utilized. They confirmed the lack of linkages to customers outside their immediate surroundings, and the need for finance, as key obstacles to enterprise growth and success. Examples of potential and existing improved enterprise business models are set out in the boxes below. The Parwan pilot also demonstrated that considerable social capital exists, as a result of the NSP, which will enable many of the sequenced activities in the program to be fast tracked. This validates the program being able to take a flexible approach in different areas depending on the situational analysis.

Program Components

12. Below is a summary of program components with details in Annex 1, and implementation methodology articulated in the operations manual.

13. **Component A: Community-led Enterprise Development (USD 40.2 million):** This component aims to create Savings Groups, Enterprise Groups and Village Savings and Loans Associations. These institutions will be assisted to build their own capacities, increase the value of trading, ensure production is oriented towards identified market opportunities, and create access to credit.

14. This Component is divided into three sub-components as follows:



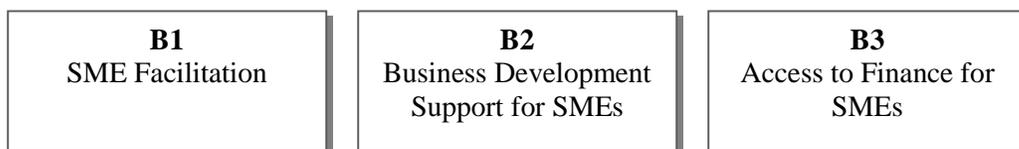
² Advice on building and operating a poultry farm, fish farming, carpet production and methods of quarrying and cutting stones for sale as building materials

15. ***A1. Community Facilitation:*** This sub-component will facilitate the formation and functioning of SGs and EGs within each community, so that men and women who engage in income generating activities can collectively access technical expertise, markets and eventually finance. Through facilitation of good governance practices, the Program will ensure that these groups are inclusive, participatory and accountable in nature. The Program's entry point will be through the CDC's male and female elected committees, and where possible will build on existing groups and institutions, e.g. Self Help Groups (SHGs), Common Interest Groups (CIGs), Cooperatives etc. The Program will finance male and female Village Facilitators (VFs) in equal numbers, who will be trained and linked to the provincial offices via cell phones, and who will work in their own communities. The Program will also appoint Provincial Enterprise Facilitators (PEF), who will operate across communities.
16. ***A2. Support to Enterprise Groups:*** This sub-component will aim to maximize the economic potential of rural entrepreneurs to improve market access, deliver technical knowledge, raise basic business skills and leverage economies of scale to increase the value of their sales. The Program will facilitate a sequenced process to build EGs' commercial knowledge and enable them to effectively articulate their needs and to identify opportunities. EGs will thus be able to access generic and specialized trainings and other support needed to create, expand and improve their business (e.g. support to carry out their own market research, make study visits to understand business models that they want to replicate). The pilot program highlighted strong demand from communities for technical training to those enterprises viewed as having good commercial potential. The Program will deliver training and support services, embedded business development services (i.e. trainings provided by traders, buyers, processors, inputs, suppliers), and through acknowledged local specialists on specific enterprises.
17. The Program will support approximately 6,500 EGs, comprising approximately 52,000 people³, of whom at least 18,000 will be women. EGs' growth and progress will be monitored in terms of their aggregate increased sales, net cash flow to the community, and the number of people actively engaged in the supported enterprises. The likely long-term sustainability of the EGs will be gauged by their ability to raise and repay loans, formulate business plans, develop marketing options and have robust institutional capacity.
18. ***A3. Access to Finance:*** This sub-component will create VSLAs, formed from federated SGs, to address the financial needs of EG members for business investment. The Program will support and train SGs with an aim to generate savings and carry out internal lending with a repayment rate of no less than 95%. Mature SGs will be encouraged to federate into higher level VSLAs. Office bearers' of the VSLA will be provided with training in managing the financial institution, appraising small commercial loans and loan recovery. The accumulated savings of VSLAs will be matched by seed capital provided by the Program, up to a ceiling of \$ 10,000. It is envisaged that approximately 13,000 SGs will be supported, and 1,300 VSLAs will be formed. It is estimated that their aggregated loan capital would be \$ 20 million over the program period, which would be available for on-

³ On average 8 persons per EG

lending to eligible members. The Program will monitor the loan portfolio of the VSLAs and their sustainability with a view to link them to formal financial institutions.

19. **Component B: SME Development (US27.3 million):** This component aims to support the emergence of a stronger SME sector with improved trading linkages with the rural economy and adequate access to financial services. The component has the following three sub-components:



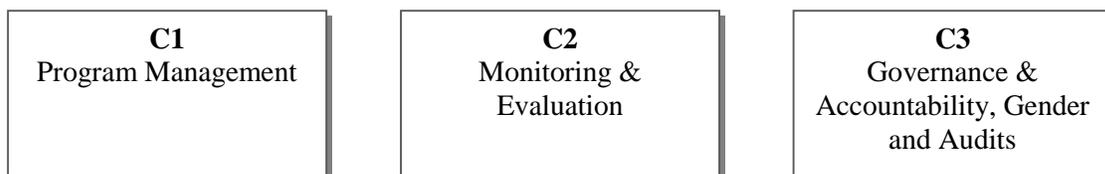
20. **B1. SME Facilitation:** The program will finance a sequenced approach for SME support, i.e. identifying key value chains in each Province, working with the stakeholders to identify choke points constricting growth, identifying opportunities for forward/backward linkages and defining skill gaps. An initial provincial situational analysis will identify local financial institutions, business development service suppliers, and opportunities for collaboration with other projects. The selection criteria for SME support is weighted towards those businesses⁴, or sectors, that are judged most likely to create demand for locally produced products and / or generate both direct and in-direct employment.
21. **B2. Business Development Support for SMEs:** The Program will work with sectors and approximately 750 SMEs which are likely to be key drivers of rural income. It will support them in building necessary skills, promoting market development and particularly encouraging business linkages with the rural economy. Action plans will be developed to enable the SMEs to access the services they need in market development, generic training and specific technical support. The program will be especially supportive of sector wide initiatives (see Bamyar example below). These services will be provided through existing suppliers, or where not available, by direct Program provision. It is likely that part of the generic business training will be provided through the three pre-selected suppliers of the IFC's "Business Edge" training programs, provided the courses are proven useful in rural Afghan circumstances. The Program will partially finance SME training and business support (to be progressively phased out), build capacity among existing suppliers of services. The Program will also promote innovations and new business models through an annual Innovation Prize⁵ of up to US\$ 50,000 for each province, in total amounting to \$1.5 million. The supported SMEs will be monitored for increases in sales, rural purchases, additional employment generated and improvement in their access to formal credit.
22. **B3. Access to Finance for SMEs:** The program will facilitate improved access to finance by SMEs through a three-pronged strategy namely; (i) the risks related to the provision of credit for rural SMEs will be addressed by setting up a risk-sharing mechanism in the form of a partial guarantee; (ii) the lack of institutional capacity and appropriate products and services will be addressed through the provision of support for capacity building and new product development for partner banks; and (iii) the Program will assist supported SMEs to

⁴ These Provincial SMEs are by definition Rural and Semi-Urban.

⁵ The Innovation prize will be particularly supportive of new and innovative approaches for local sourcing of raw materials and products from the rural areas.

identify and present their financing requirements in line with the needs of partner banks. The partner banks will be selected for each province on the basis of pre-determined eligibility criteria that will include track record, commitment, capacity and alignment with the program's objectives. The program will monitor the change in the levels of SME financing. It is expected that the overall strategy will strengthen SMEs and thus make them more attractive clients for financial institutions.

23. **Component C: Program Implementation Support (US\$24.3 million):** The component will support MRRD in *C1. Program Management*: establishing and implementing an effective Program management system through, the provision of training and technical assistance, equipment, operating costs, to strengthen the Program Management Office's capacity in financial management, procurement and technical skills; *C2. Monitoring & Evaluation*: designing and implementing an efficient monitoring and evaluation system; and *C3. Governance & Accountability, Gender and Third Party Audits*: designing and implementing the Governance and Accountability Action Plan, Gender Action Plan and carry out external and internal audits. The sub-components are:



24. **Developing Synergies between Components A & B:** The Program will facilitate the better integration of key provincial value chains, and through consultations with producers, SMEs and other stakeholders, identify and address major choke points. The Program will, amongst other criteria, select to work in areas that have good potential to provide labor and products for these selected value chains. PEFs and BDO will co-operate to actively promote trading linkages between EGs and SMEs. The program will aim to leverage the embedded business development skills of SMEs to deliver practical and market oriented trainings to EGs.

Eligibility for Processing under OP/BP8.0

25. All lending operations, except for additional financing under OP/BP 13.2 continue to be processed under OP/BP8.0. Furthermore, AREDP meets the eligibility under OP/BP8.0 as it aims to restore "the means of production and economic activities" (OP8.0, para 4) by (a) providing livelihood opportunities for rural communities of Afghanistan; (b) facilitating provision of enterprise support services, improving access to financial resources, and strengthening the ability of GoA to deliver these services are key elements of the country's development, especially at times of growing insecurity and economic downturn; and; (c) the proposed interventions are key to improving the Government's credibility to win communities' support and to foster peace building in the country; and mobilizing other development partners to assist the GOA/MRRD to make effective use of the donor assistance in the public and private sector.

26. Financing

Source:	(\$m.)
BORROWER/RECIPIENT	0
International Development Association (IDA)	30.00
Other financing amounts by source:	
DfID Through Afghanistan Reconstruction Trust Fund (ARTF):	23.00
Total	53.00

AREDP is being designed as a \$91million program however within the current budget envelope AREDP will be rolled-out in five provinces and later scaled-up, with additional funds, eventually to all 34 provinces of the country.

Implementation and Institutional Arrangements

27. Through the Project Preparation Facility (Project Preparation Facilities), the Government of Afghanistan has already set up the Afghanistan Rural Enterprise Development Program (AREDP) that is being managed by Program Management Office within MRRD. The institutional and implementation arrangements outlined below will be carried out according to the rules and procedures agreed in the Operations Manual (OM)⁶. The OM outlines roles and responsibilities of the implementing agencies and provides details of program cycle and processes. The OM will be subject to periodic joint reviews in the light of field experience.
28. **Overall program oversight** will rest with a Program Steering Board (PSB), chaired by the Minister of Rural Rehabilitation and Development and including representatives from various ministries, donors, private sector institutions will be responsible for the overall policy, strategic planning and project oversight.
29. **Institutional Arrangements** have been designed to support the program initiatives at the community, village, province and national levels. The primary agency responsible for program's implementation will be the Ministry of Rural Rehabilitation and Development (MRRD) of Government of Afghanistan. Within the current budget envelope AREDP will be rolled-out in five provinces, and later scaled-up, with additional funds, eventually to all 34 provinces of the country. The first set of provinces identified for program implementation is Parwan, Ningrahar, Bamyán, Balkh and Herat. They have been selected because of their potential for enterprise development, security and accessibility, significant number of good quality Community Development Councils (CDCs) created by NSP and track record of implementing NSP. When rolling out in these provinces, AREDP will first target more promising districts until further funding and capacity is developed within the program to scale up further. The Program will identify CDCs in the select districts and develop strategies to avoid duplication and create synergies with similar efforts in organizing community level enterprises by, for example, The Aga Khan Development Network, USAID, and others.

⁶ The OM is based on the experiences gained during the implementation of pilots, similar projects and the outcome of various workshops, studies and analyses that were carried out as part of program preparation.

30. In each of the program participating provinces, a Provincial Office (PO) will be established. Each PO will be headed by Provincial Manager and staffed with a Finance Officer, an Administration Officer, a Monitoring and Evaluation Officer and an MIS/Data/IT Officer. Provincial Manager will plan, manage and supervise the implementation of Components A and B with the team of Provincial Enterprise Facilitators (PEFs) and Business Development Officers (BDOs). At the village level, AREDP will closely coordinate and collaborate with Community Development Council (CDC) for the implementation of Component A.
31. The program will engage service providers for trainings to the community groups and SMEs, as well as for other activities. A transparent and quality ensuring mechanism will be in place to identify and engage competent providers with good track records.

Sustainability

32. The AREDP is designed to build strong institutional mechanisms for promoting rural enterprises, delivery of support services and organizing market linkages through value chain linkages. Three critical aspects of sustainability have been considered during Program design: the community-based institutions formed and strengthened through the Program must survive and thrive even after the Program exits; the enterprises that are formed and supported must remain economically viable over time; the various support and linkages mobilized by the Program must continue in the long-term. Some specific steps that will be taken to ensure sustainability are as follows:
33. The Program will facilitate savings groups, enterprise groups and village savings and loans associations (VSLAs) at community level. These community-based institutions will be facilitated to develop self-management and performance tracking capacities, in particular the management and technical skills to ensure transparency, good governance and conflict management. Many of the savings groups will be federated into VSLAs, which will operate as 'for-profit business enterprises' and will have participatory and transparent governance structure and prudent financial systems. The VSLA have potential to partner with commercial banks and Microfinance Institutions to deliver financial services in their local area.
34. The economic sustainability of the enterprises will be ensured through the following: strategic focus on high growth rural sectors; enhanced access to financial services by linking up with commercial banks and MFIs; increased investments for replacement and expansion of productive assets; productivity gains and higher unit value realization through improved business skills and access to business development services; aggregating community enterprises into producers' associations to derive economics of scale and access to wider markets.
35. Sustainability of linkages and other support services will be facilitated as follows: the program will develop markets for private provisioning of support services (like skill training extension, input-supply, market facilitation, etc.) by building capacity of suppliers of business development service and progressively reducing subsidies; it will leverage credit lines to VSLAs, and will make credit available to rural SMEs through the commercial banks and MFIs; it will extend product development assistance, partial guarantee facility, etc. with select partner banks to increase their exposure to rural SMEs; it will coordinate value chain linkages between community enterprises and rural oriented SMEs and private sector

companies. Besides, it will foster innovative business linkage models through innovation prize mechanism.

36. The Government of Afghanistan intends to evolve AREDP as an autonomous entity backed by enabling legislation or a regulation. This entity is envisaged to be capable of generating independent revenue streams with little implications on GOA budget after the close of this Program. Based on the results achieved and lesson learnt, it should be possible to examine the feasibility of a follow-up operation to scale up, with some external financing support, the successes of AREDP across the country.

37. Safeguard Policies (including public consultation)

Safeguard Policies Triggered (<i>please explain why</i>)	Yes	No
Environmental Assessment (OP/BP 4.01) This policy is triggered as AREDP is funding local rural small industries, and SMEs having potential for adverse impacts on the safety as well as the local environment of the relevant communities. Therefore, the project needs to assess the potential subprojects activities, their impacts as well as the needed mitigation measures.	X	
Natural Habitats (OP/BP 4.04)		X
Forests (OP/BP 4.36)		X
Pest Management (OP 4.09)		X
Physical Cultural Resources (OP/BP 4.11)+		X
Indigenous Peoples (OP/BP 4.10)		X
Involuntary Resettlement (OP/BP 4.12)		X
Safety of Dams (OP/BP 4.37)		X
Projects on International Waterways (OP/BP 7.50)		X
Projects in Disputed Areas (OP/BP 7.60)		X

38. Contact

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