Ministry of Agriculture, Livestock, Lands and Irrigation

Matching Grant Manual

Smallholder Agribusiness and Resilience Project (SARP)

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1. Introduction

A number of studies have confirmed that smallholder farmers cultivating under village irrigation systems are poorer and more vulnerable than dry zone counterparts who have access to major irrigation. These farmers are much more vulnerable to the impacts of climate change than farmers cultivating under larger irrigation systems. As productivity and crop yields decline with low water availability and unseasonal rains, resulting from climate variability and extreme events, smallholder farmers are dragged deeper into poverty and face food deficits which have to be met by buying food for consumption, increasing the level of indebtedness and further eroding their capacity to cope with climate risks.

The dry zone, however, has significant scope for agricultural productivity growth both through traditional and non-traditional agriculture and the potential for better linkages to domestic and export markets for fresh and value-added production. Given the centrality of tanks to the agrarian livelihoods of dry zone farmers, their current levels of neglect and the increasing vulnerability of these areas to both droughts and floods in quick succession with consequent impacts on agricultural production and incomes, the rehabilitation of tank-based irrigated agricultural systems is key to improving the resilience of these areas and the agrarian communities that depend on them.

The 'Hot-Spot' area development approach aims to enhance resilience of these areas and those who depend on it for their livelihoods by (1) the flexible and adaptive management of existing and improved irrigation water storage and delivery structures to make irrigation more reliable in the face of rising climatic variability; (2) better agricultural inputs, techniques and practices that, along with the additional water assist farmers to better stabilize their crop yields and reduce crop losses in the light of climatic variability; and (3) better access new markets and higher prices through better post-harvest management and value addition and inclusion in competitive value chains.

Climate Smart Irrigated Agriculture (CSIA) addresses some of these challenges by addressing climate change adaptation whilst ensuring food security. The urgency and rationale for climate resilient economic development to benefit dry zone farmers is extremely relevant.

2. The goal of SARP

The overall objective of SARP is to contribute to Sri Lanka's smallholder poverty reduction and food security in the dry zone region.

3. The Development Objective

The development objective is to build resilience and market participation of 40,000 rural smallholder households in the project area.

4.Project area and targeting

SARP will focus on priority districts in the North, North Central, Central, and North Western provinces of the dry zone. The project will target rain-fed cascades and nearby villages within the selected three river basins – the Malwathyu Oya, Mi Oya and Deduru Oya, as most vulnerable, ecologically and socially. The selected cascades are located in so called 'hot spot' geographical areas where farmers and farming livelihoods are highly exposed and vulnerable to increasing climatic variability.

- Target group of agribusiness development activities such as 4P, Youth and Resilience activities, All target groups must be **within the 3 basins and 6 districts**.

4. **Project proposal development and Inclusion of matching grant support for value chain players**

All 4P sub-projects and youth business initiatives, ensuring that resilience activities are market-oriented and sustainable, focusing rural finance activities, and ensuring effective infrastructure completion to design project objectives.

Accordingly, the challenges and opportunities identified through value chain analysis need to be addressed during project proposal development and supported through SARP funding. The Climate smart agricultural technologies will be promoted to mitigate the impact of climate vulnerability in order to create an attractive opportunity for women and youth to engage in agribusinesses to enjoy quick and timely benefits. However, there are challenges that need to be met.

5.1 Opportunities for impact & Key Entry Points for financial inclusion for agribusiness value chain development

Challenges	Opportunities
Vulnerability for climate change	• Introduction of climate smart practices into cultivation (Ex: Protected agriculture, micro irrigation etc.) • Enhance the availability of water by rehabilitation of minor tanks and sustainable cascade management. • Encourage rain water harvesting techniques • Crop diversification and conserve water • introduce good agriculture practices (GAP)
Prevalence of pest and diseases	• Incorporation of Integrated Pest Management (IPM) practices. • Introduce good agricultural practices (GAP) • Introduce crop insurance
Post-harvest loss	• Encourage correct time of harvesting • Implementation of safe handling practices, cleaning, sorting, grading, storage and packing methodologies. • Introduce good manufacturing practices (GMP)
Unavailability of proper distribution network	• Implementation of safe transportation technologies (ex. Temperature regulated transport) • Develop road network to facilitate input delivery, and marketing of farm produce – from the farm to the collecting center or to the processors, traders and exporters etc.
Farmer profitability	• Introduce record keeping and financial literacy training • Introduce technologies to improve productivity (FFS training)

	• Organize production base and assist them to preserve quality and minimize post-harvest loses. • Provide FBS training • Minimize COP by introducing climate smart technologies, machineries and tools for cultivation and postharvest handling etc.
Market accessibility	• Farmers are encouraged to produce for the market Organize production base for bulk marketing • Preserve quality by introducing collecting centers and primary processing facilities • Ensure market by establishing buy-back arrangements with promoter companies or organizations
Farmer capacity to invest in Agribusiness to mitigate impact on climate change	• Introduce appropriate climate smart technologies • Introduce matching credit support to fill the gaps in farm investment • Introduce matching grant support as a start-up fund to introduce climate smart technologies
Risk associated with agriculture due to the farming in vulnerable 'hot spot' areas	• Introduce climate smart technologies • Introduce crop insurance • Introduce and produce for the market by establishing buy back arrangement with the potential buyers • Provide matching grant support as a start-up fund support to introduce climate smart technologies • Improvements to tanks and water distribution network • Encourage rain water harvesting

5. Matching grant support

5.1. Justification

Considering the project locations selected – so called 'hot spots' in dry zone of Sri Lanka - the smallholder farmers in the project areas are frequently exposed to climatic variability. Hence, their household income, credit worthiness and the exposure to the new knowledge and technologies are at a very low level.

Therefore, following interventions are required to achieve the overall objectives of the SARP and the matching grant component proposed is more justifiable for the farmer in the hot spots to engage in profitable agribusiness enterprises in a sustainable manner.

i. A relatively higher level of investment by these beneficiaries is required to achieve climate resiliency (as well as commercial sustainability) because they are based in the dry zones where the SARP project is operating

ii. Matching grants are required to unlock credit from partner financial institutions.

iii. Promoter companies or other organizations are more reluctant to invest in agribusinesses in the project hot spot areas where the investment in agriculture is riskier compared to other areas. In order to motivate and promote private sector companies and other organizations involved in agribusiness development partial matching grant support is proposed for 4P promoter companies.

In order to encourage private sector investment in improving value chain development efficiencies matching grant support for machinery and equipment and/or infrastructure can be considered on the basis of 25% of the total capital investment (25% SARP matching grant, 75% promoter contribution). The balance 75% of the investment as of the cost estimate should be met by promoter own funding or credit arrangement to encourage them to invest in value chains.

IV. In the case of investment in individual farmer is not economical and viable due to small production and the difficulty in maintaining the quality of the produce. The establishment of collecting centers, small scale group processing facilities, storage facilities, market infrastructure etc. could be considered as a group activity and supported under matching grant component of SARP.

5.2. Implementation arrangement

In order to reach the development objective of the project to build resilience and market participation of 40,000 rural smallholder households in the project area a combination of matching grants and loans will be offered to them while enhancing the stability and sustainability of their farming systems and other able-bodied persons including entrepreneurial small farmers to provide commercial goods and services (input supplies, mechanization, spraying, transportation etc.) to farm households. The selection of viable business ventures will be guided by the findings of the value chain studies and identified opportunities for linking small farmers' POs to economic partners locally as well as larger scale input dealers, traders, exporters, retailers, and processors.

Agricultural machinery and equipment for hire service providers is seen to be an attractive and feasible source of income for young entrepreneurs and will be supported by youth employed in repair workshops. Other potential businesses for youth and women flourishing in the Dry Zone are protected agriculture, quality seed production, semi commercial dairy, and goat production. Further, under 4P projects opportunities for youth to engage in agribusinesses could be identified as service providers and need to be supported through matching grant component for the benefit of value chain.

4P, Youth and Livelihood resilience agribusiness proposals will be prioritized to enable small farmers organized into groups/ organizations to increase their productivity, reduce post-harvest losses and respond competitively to increasing market demands for high value products could also be supported through matching grant and credit support. Matching grants at a ratio of 70 percent (IFAD loan) and 30 percent (beneficiaries – in kind, credit and cash) will be set. The applied matching grant ratios and funding ceilings will be periodically reviewed and recalibrated to take account of the changing circumstances and lessons learned during project implementation in order to establish sustainable value chain activities, especially 4P and YED activities.

The agro-enterprise team will review the project proposals/ business plans. Service providers and business coaches will support applicants to develop sound business plans and improve their marketing, business, technical and managerial skills, to be packaged in the micro-projects. Detailed application procedures and eligibility criteria, including eligible interventions and expenditures for the matching grants will be developed by the project as a start-up. Evaluation of proposals/business plans will also include outreach to poor households, integration of gender, youth, nutrition and climate change aspects.

To promote agribusiness enterprises, combinations of matching grants and loans will be offered to SARP beneficiaries, as an Incentive mechanism, will be applied for introducing and promoting innovative technologies, particularly with respect to resilience by individuals and agri-entrepreneurs. Other potential businesses flourishing in the Dry Zone are protected agriculture, quality seed production, semi commercial

dairy and goat production etc. Small post-harvest management (PHM) investment grants will also be offered to households to fund investments in post-harvest and value adding technologies.

Taking into account the findings of the value chain studies, existing POs and interest groups, committed to take on investments in improving their farming business, will be supported with further training and technical assistance. The aim is to enable them to meet the eligibility criteria for investment matching grants.

Assistance for group activities could be identified through the 4P projects, Promoter led youth projects, or Livelihood Resilience development projects considering the beneficiaries commitment, participation and demonstrating the technical and financial feasibility of the proposed project intervention which will support the promotion of market driven agribusinesses. Based on the experience in Sri Lanka it is estimated that for group activities the average producer group level average small investment project grant support will be about US$7,000.

The Grant disbursement for value chain activities will be performance based, phased, and linked to achievement of key development and business milestones, agreed in the grant contract. Grantees will be provided with training to build their capacity to accurately account for the funds received before disbursements. The agro-enterprise team in the PMU will engage with the grantees to ensure full accountability.

Youth Agro-enterprises under subcomponent 2.2 will be more substantive with activities budgeted $3,000 as an average grant size per beneficiary. Some of these investments are envisaged as partnerships and/ or for small groups. Where as in 4P projects matching grant of US$ 2,000 will be considered as an average grant size per beneficiary to introduce climate smart technologies identified through the 4P project proposal. For the livelihood development resilience projects average matching grant size of US$ 400 will be considered for a beneficiary depending on the project proposal.

As part of the policy on grants and incentives, individuals (youth and 4P projects) could aggregate these amounts as part of a partnership or group activity. Matching grants at a ratio of 70 percent (IFAD loan) and 30 percent (beneficiaries) will be set (Refer cost tables). The applied matching grant ratios and funding ceilings will be periodically reviewed and recalibrated to take account of the changing circumstances and lessons learned during project implementation.

Respective line agency support should be taken for project designing and implementation and recommending matching grant support as of the case may be. Ex for installation of micro irrigation systems, cattle shed renovations etc.

5.3. Financing SARP business plans

In order to encourage value chain players to invest in above projects different assistance packages were introduced identifying gaps in value chain and investment capacity of the farmers and other players. Accordingly, the proposed assistance package comprised of matching grant support, matching credit support and training and capacity building support.

5.3.1. Guideline for matching grant support

Value chain player	Av. Grant %	Own contribution (Matching credit, in-kind and own contribution%	Av. Matching Grant size US$	Remarks/ Implementation arrangement
4P beneficiary	70	30	2,000	Matching grant for machinery, equipment, tools, Seed material and infrastructure will be released after procurement.
4P / promoter	25	75	20,000	Matching grant for machinery, equipment, tools and infrastructure will be released after procurement, installation, and commissioning as of the case may be.
YED beneficiary	70	30	3,000	Matching grant for machinery, equipment, tools, Seed material and infrastructure will be released after procurement.
Livelihood dev. Beneficiary	100	00	400	Targeting small scale agribusiness project interventions. Mainly for capital expenditure.
Project investment on group activities benefitting farmers in any agribusiness value chain project	80	20 (Promoter or beneficiary contribution or both)	7,000	Project intervention Identified through the value chain - postharvest handling, primary processing, storage, value addition activities etc. Mainly for capital expenditure

Matching grant support is mainly for capital investment but matching credit facility can be considered as start-up fund support for the investment. Promoter matching grant support will be decided based on the number of beneficiaries supported during the first phase of the project. The average grant size also depends on the scale of operation.

5.3.2. The details of matching grant support to promoters are given below.

Beneficiary number	Matching grant proposed as a % of the cost of the items recommended	Maximum amount of matching grant support in SLR MN
< 200	25% of the cost	3.00
200 - 500	25%	4.00
> 500	25%	6.00

5.3.3. The summery of the average matching grant size - beneficiary category wise under different agribusiness development enterprises.

Type of intervention	Average grant size US$	Beneficiary contribution (Credit, cash, in-kind) US$	Grant size from the total project investment	Remarks
4P beneficiary	2,000	600	70% grant support	
YED Beneficiaries	3,000	900	70% grant support	
4P promoters /promoter led youth projects	20,000	60,000	25% grant support	As a % of the cost table capital expenditure. Matching grant size will be decided based on the criteria given in the 6.3.2. table
Group interventions	7,000	1,750	80% grant support	

6. Use of IFAD Grant (US$ 1 million)

The use of the IFAD Grant moving forward will be broader, supporting policy and technical studies, as well as capacity building activities identified by the Project Management Unit (PMU). Each of these activities will be subject to IFAD's No Objection before proceeding.

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