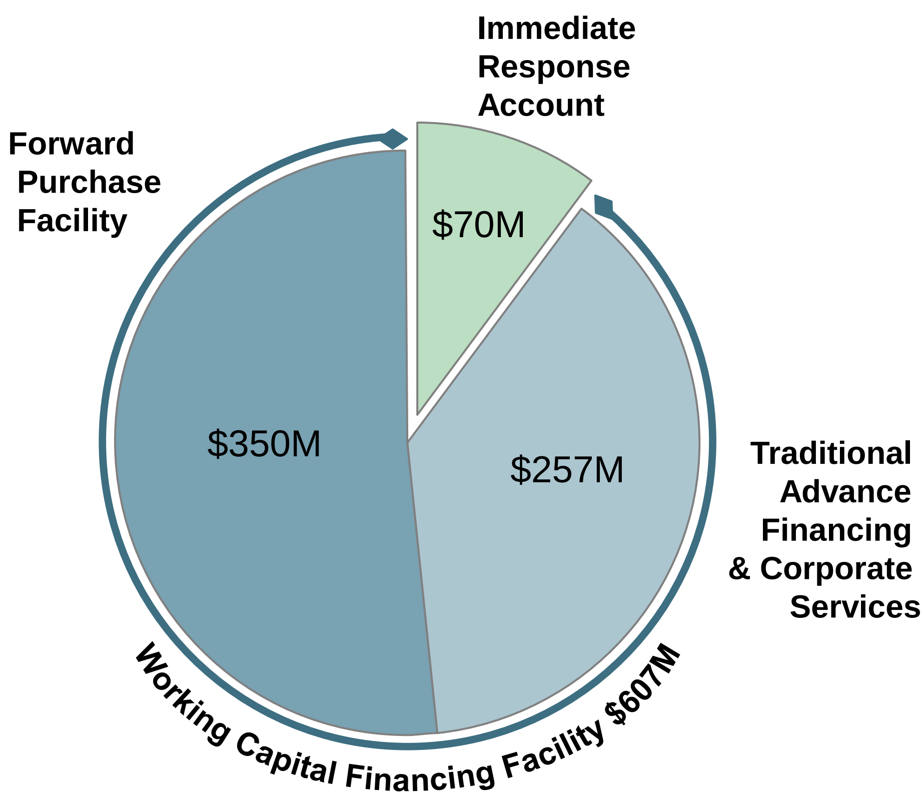
Working Capital Financing Facility review

Informal Board consultation

April 2nd, 2014

Introduction – Scope as presented at 11 February

Overview of current Financing mechanisms



Terms of Reference

The **Boston Consulting Group** (BCG) was asked to conduct a comprehensive review of WFP's current financing mechanisms

We have adopted a **holistic approach**, focusing on the Working Capital Financing Facility

Our assessment has been centered around **two key questions**:
- *How can clarity and effectiveness of the overall framework be improved?*
- *How can more impact be achieved, while maintaining acceptable risk levels?*

This document presents our **emerging recommendations** and serves as a basis for further analysis taking into account your reflections

What we have done

Data gathering

Interviews & workshops

- Country Offices
- Regional Bureaus
- PGG & selected DROs
- CFO, RMB, RMF, RMI & RMP

Data sources

- Status of Advance Facilities
- Contributions & Forecast stats
- Individual loan requests
- Previous Board papers
- WFP online databases

Recommendation building

Topics investigated

- Overall financial framework
- Different advancing mechanisms
- Risks & risk mitigation measures
- Need & impact

Supporting analyses

- Contributions mapping
- Loan book analysis
- Forecast analysis:
  - Available collateral
  - Forecast accuracy

Principles applied during our review

✓ **Maximize impact to beneficiaries...**
- Ensure best use of funds and enhance stability of funding for COs
- Optimize operational efficiency

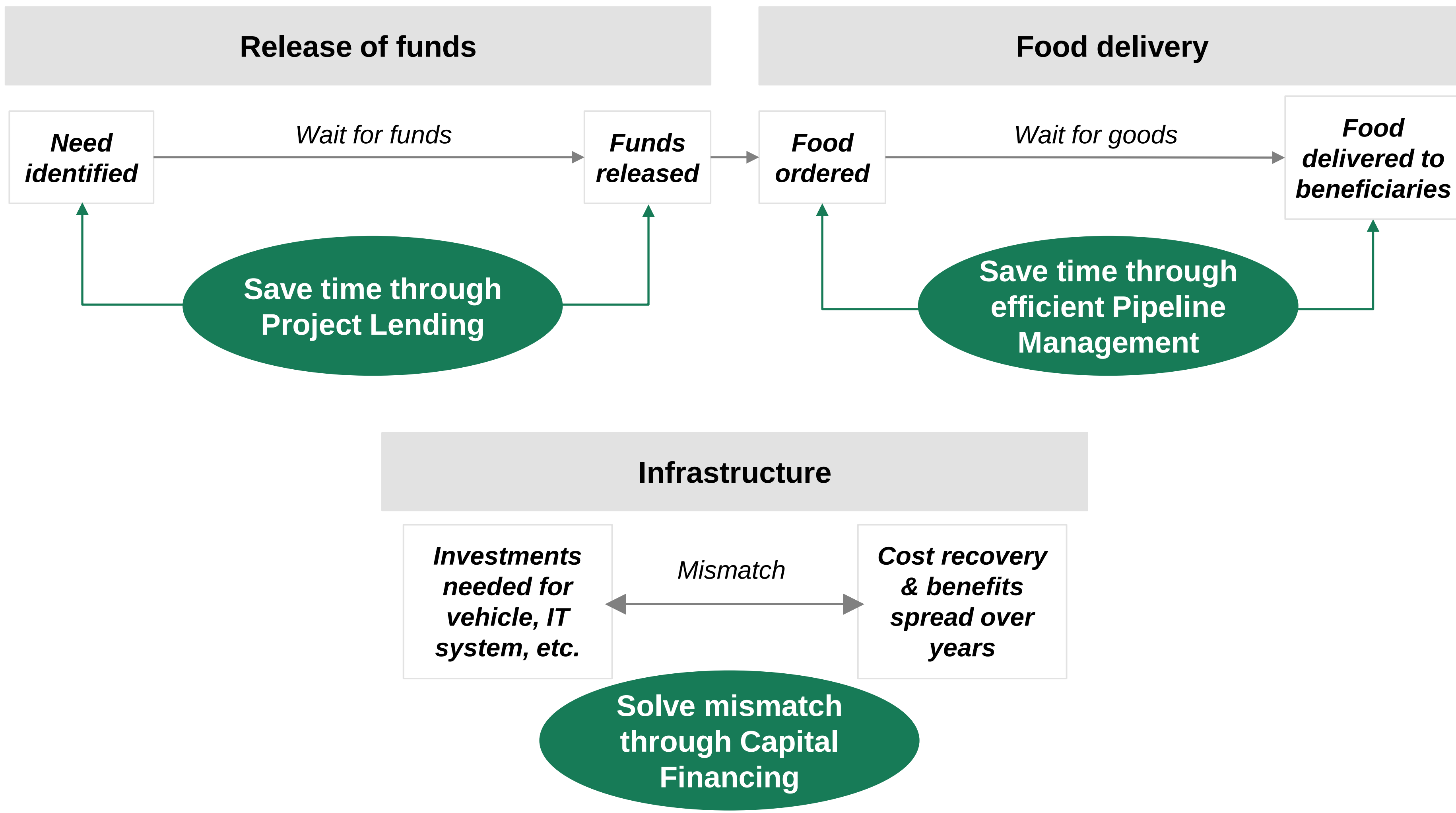
✓ **... while maintaining acceptable risk levels**
- Appropriate risk management

✓ **Preserve 100% voluntary donor model**

✓ **Respect donor preferences on usage of funds**

✓ **Enhance transparency to all stakeholders**
- Pursue simplicity & clarity and ensure accountability for fund usage

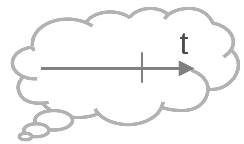
There are three different financing needs within WFP



Existing WFP financing framework covers all these needs

Need		Mechanisms		Benefits	Ceiling	Leverage factor	Reserve
Project Lending		**Immediate Response Account (IRA)**	• Immediate assistance in life-saving emergencies	• Ability to react in life-saving emergencies • Accelerated impact	$70M	1:1	$70M
Project Lending	Working Capital Financing Facility	**Traditional Advance Financing (TAF)**	• Loans to projects with forecasted contributions as collateral	• Increased stabilization of funding for COs • Avoidance of pipeline breaks	$607M	6:1	$101M
Pipeline Management	Working Capital Financing Facility	**Forward Purchase Facility (FPF)**	• Food purchasing in advance of requests from projects	• Reduced food delivery lead times • Efficiency gains thanks to timing and scale effects			
Capital Financing	Working Capital Financing Facility	**Corporate Services (CS)**	• Advance financing for corporate services such as vehicle purchases	• Increased efficiency of corporate services			

These funding mechanisms serve very different purposes

		What is funded?	What is the risk?
Traditional Advance Financing (TAF)	***Need identified*** → *Wait for funds* → ***Funds released*** **Save time through Project Lending**	 *Forecasted projects*	**Forecasts not materializing**
Forward Purchase Facility (FPF)	***Food ordered by CO*** → *Wait for goods* → ***Food delivered to beneficiaries*** **Save time through FPF**	 *Food inventory*	**Food losses**
Corporate Services (CS)	***Large upfront capital investments*** ↔ *Mismatch* ↔ ***Benefits spread over several years*** **Solve by Capital Financing**	 *Cars, IT systems, etc.*	**Loss of assets** **Planned benefits not materializing**

Analysis and emerging recommendations

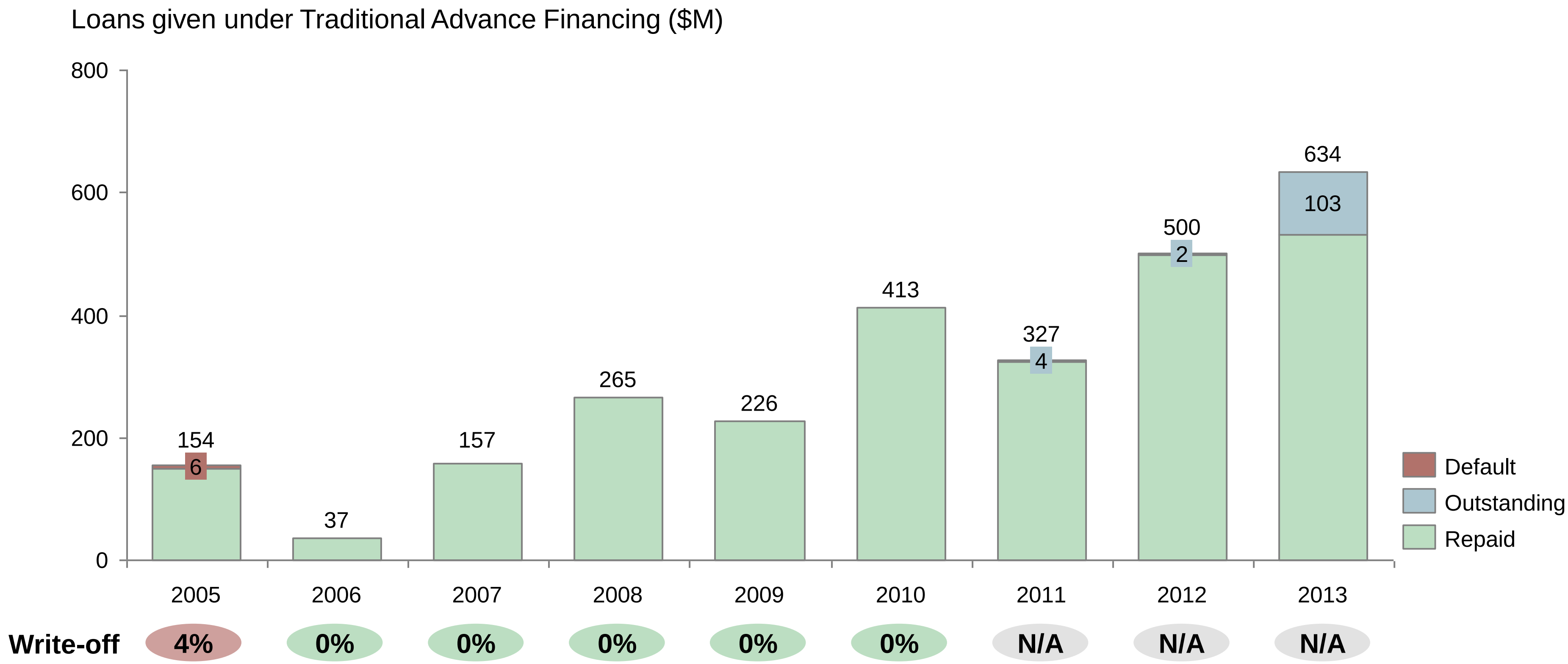
How does each funding mechanism work?

How can impact / risk be improved?

1. Traditional Advance Financing (Project lending)
2. Forward Purchase Facility (Pipeline management)
3. Corporate Services (Capital financing)

TAF (Traditional Advance Financing): How does this work and how can "impact / risk" be improved

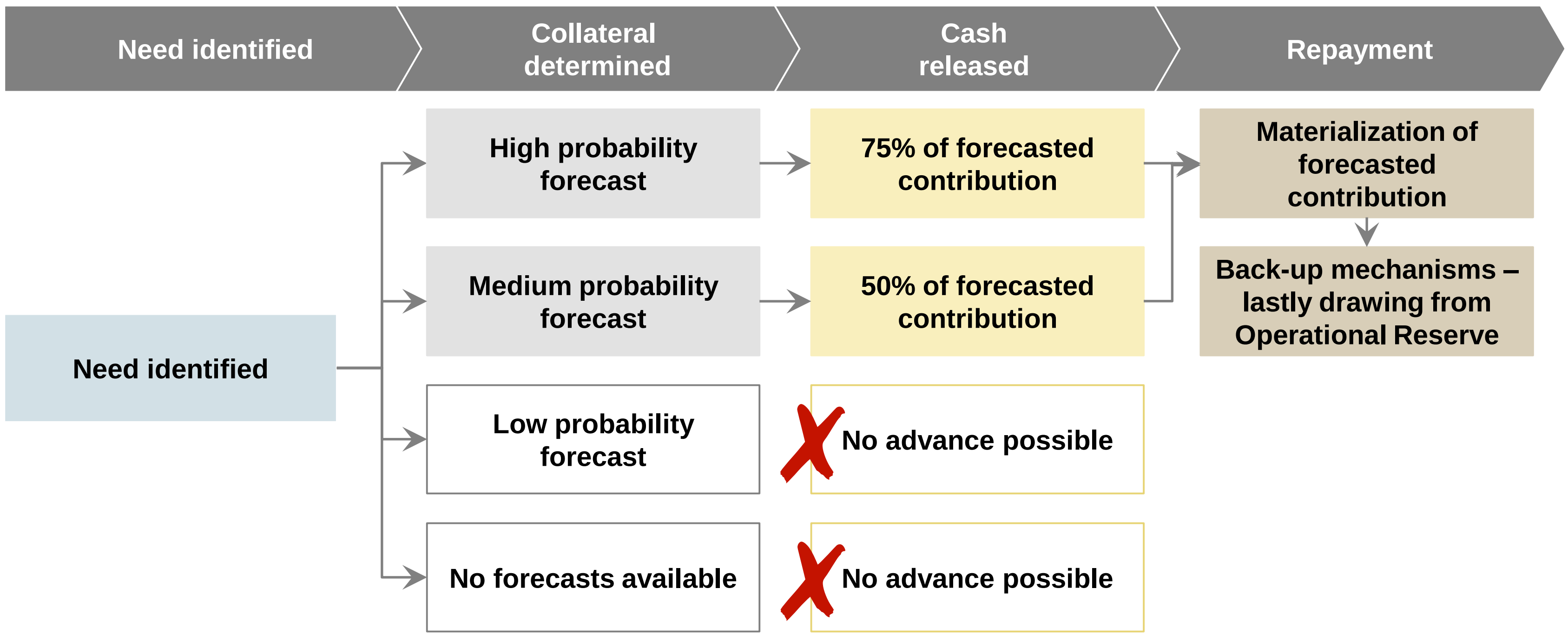
Traditional Advance Financing with very low risk today...



Source: WFP - Status of the advance facilities as at 5 February 2014, BCG analysis

... because of conservative risk management processes

How does it work today?

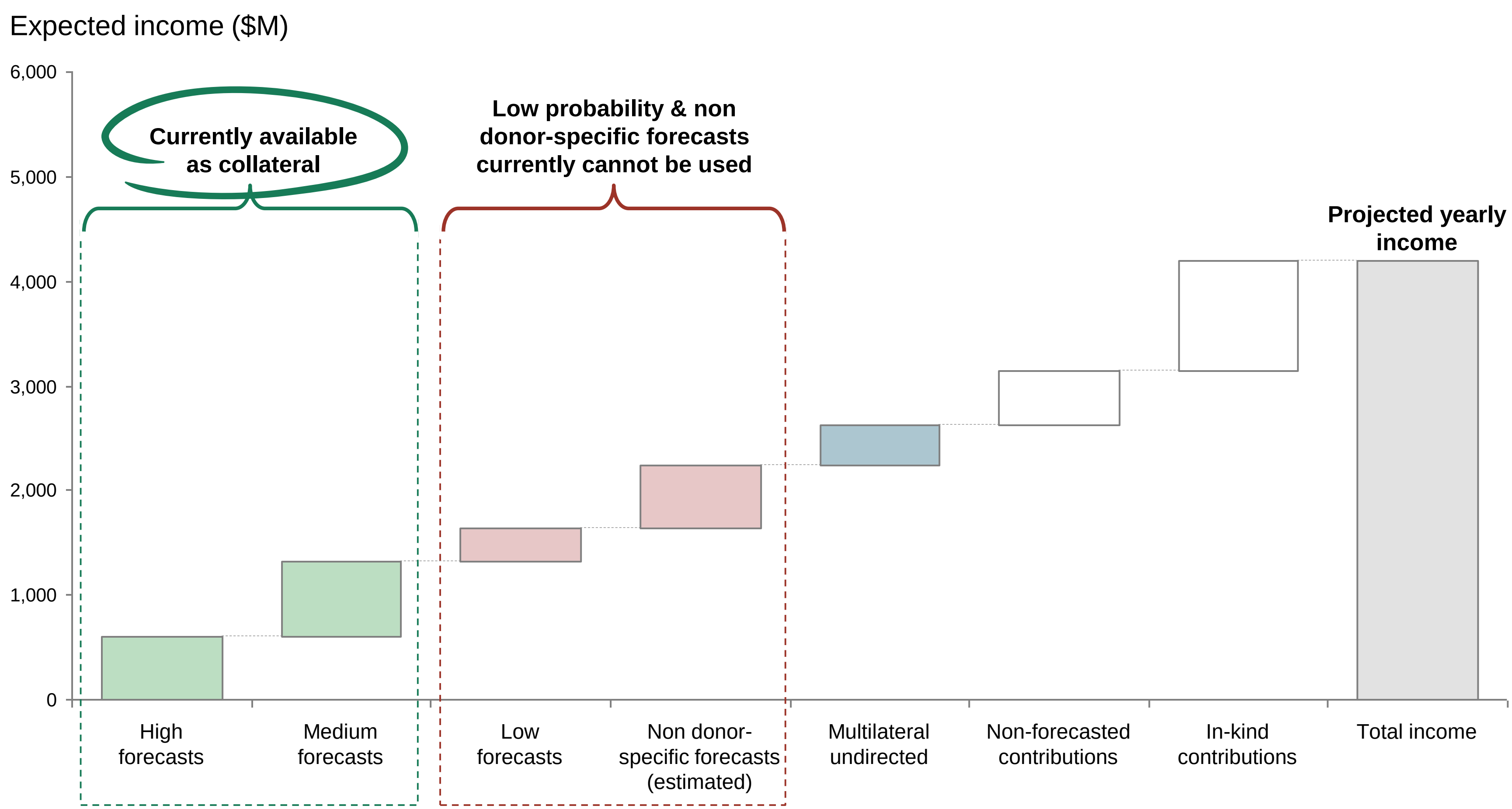


If need identified and high/med probability forecast available, TAF can be applied for

Advances are paid depending on forecast probability

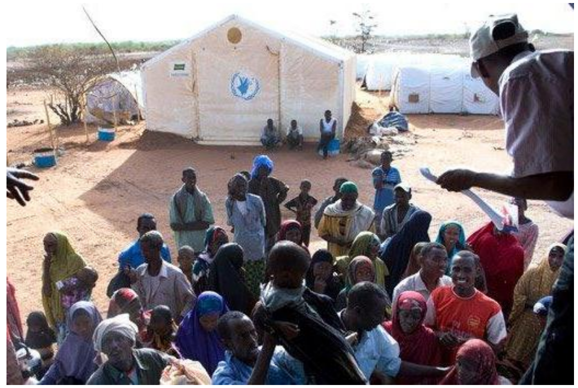
Advances either repaid through materialized forecast or through back-up mechanisms

30% of yearly income can be used as collateral for TAF



Note: ~10% of forecasts can not be used due to donor restrictions
Source: WFP, BCG analysis. updated 27 Jan 2014

Example of a project which has not been pre-financed on time



In October 2013, Ethiopia was facing a major pipeline break ...

Without immediate funds, food would run out by December 2013

$18M was needed to pre-position food and ensure distribution from December to March for over 400 000 refugees

Even though this project had been well funded in retrospect and was expected to continue to attract sufficient contributions...

...No medium and high probability forecasts were available, and therefore no advances were possible within the current TAF mechanism

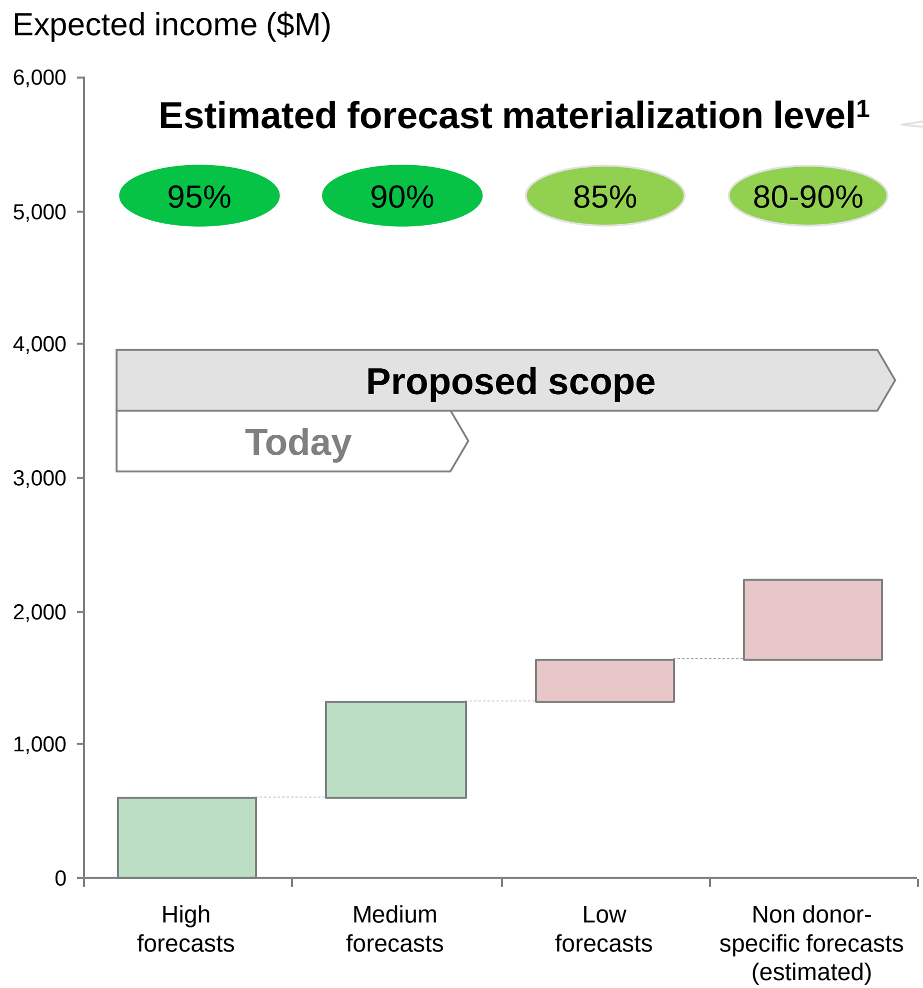
2 months later a SRAC approved advance of $18M using multilateral undirected as collateral

The delay had serious implications on the project

Source: WFP Operations in Ethiopia – Pictures taken by Albert Gonzalez Farran and Andre Liohn - World Food Programme

Proposal 1: Extend acceptable collateral for advance financing

Risk level will remain low and can be managed



Forecasts accuracy expected to remain high, leading to limited additional risk

Risk would be manageable with appropriate risk mitigation measures:

- Limiting advances to % of forecasted contribution based on level of risk
- Prioritizing "safest" collateral available
- Dynamically managing collateral as forecasts change
- Setting strict repayment rules

1.Estimations based on 2013 forecasts materialization levels and assessment of future forecasts
Source: WFP – Forecasts and contributions data 2013, BCG analysis. updated 27 Jan 2014

FPF (Forward Purchasing Facility):
How does this work and how can "impact / risk" be improved

FPF is an operational pipeline management tool

What is it used for?

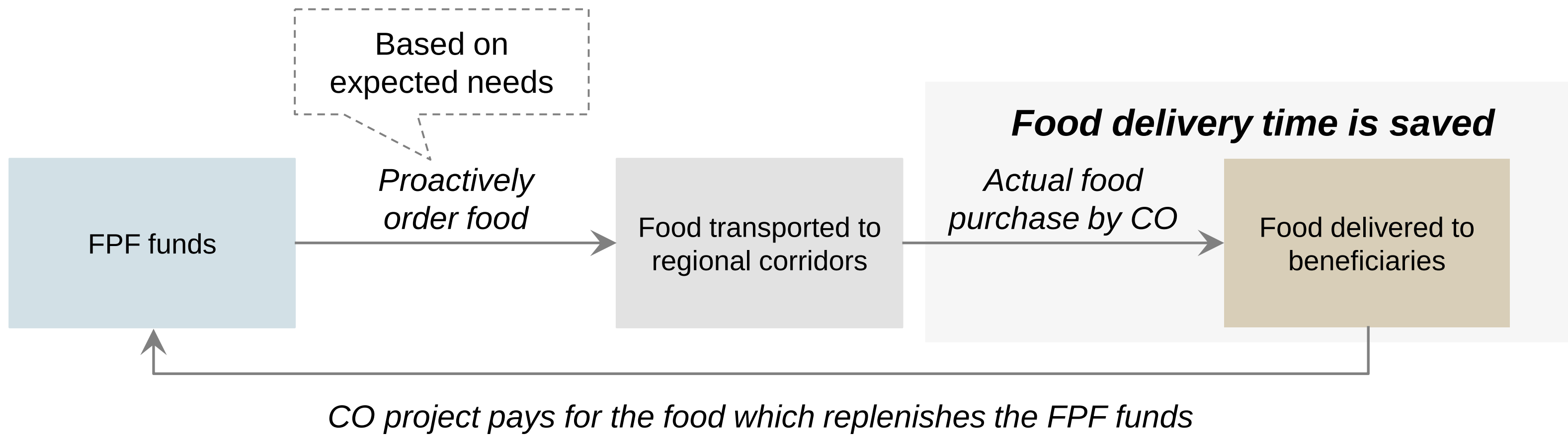
Reduce supply lead time
(Time between CO food request and delivery)

Pre-filling regional pipelines so that food orders from COs can be fulfilled much faster

Allow food procurement cost savings
(to a lesser extent)

Large volume food purchases and when possible, at favorable times (when prices are low)

How does it work today?

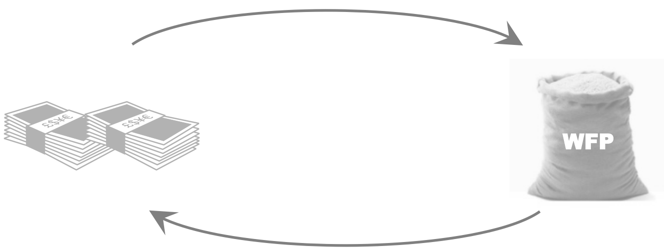


Proposal 2: Cover FPF risks via insurance and pricing policy...

... And not through a dedicated reserve as today

FPF is working capital

Cash is used to build inventory



Inventory is sold to projects and cash comes in again

Risks can be more effectively covered

Food losses due to **external factors such as weather**	**Self-insurance** covering the lifetime and multiple external factors[1]
Food losses due to **exceeding expiry date**	**Pricing policy that includes a small** % to cover normal wastage[2]

Therefore, no need to put aside a dedicated reserve

1. Might be complemented with external insurances for losses exceeding a particular limit. 2. Normal amount of wastage would be estimated using historic numbers as well as supply chain benchmarks

CS (Corporate Services):
How does this work and how can "impact / risk" be improved

Corporate Services facility allows pre-financing of investments

What is it used for?

Streamline and optimize centralized vehicle procurement	Advances to the Global Vehicle Leasing Account
Allow large long-term investments in corporate services	Capital Budgeting Facility
Allow centralized management of corporate services cost	Advances to Special Accounts, e.g., for IT licenses and staff security

How does it work today?

Need identified	Collateral determined	Cash released	Repayment
Large upfront payment needed	Expected benefits for Country Offices	100% of cash need	Piecemeal repayment by COs who benefit from capital investment

Proposal 3: Corporate Services' risks should also not be backed by a dedicated reserve

Any associated risks can be covered effectively

Country Offices lacking funds to fulfill cost-recovery schemes	Clear and appropriate repayment and backup procedures
Loss of assets *e.g. vehicles*	Appropriate insurances
Benefits of investment not materializing[1] *e.g. for software investments*	Active benefit tracking

Write-offs for this mechanism exceptional – in the unlikely event of a write-off, the PSA Equalization Account can be used as back-up

Therefore, no need to put aside a dedicated reserve

1.This would lead to faster depreciation of the investments than initially planned

Overall Framework

Proposal 4: Adjust overall WFP financing framework

Mechanisms			Ceiling	Leverage factor	Reserve
Project Lending	Immediate Response Account (IRA)	• Immediate assistance in life-saving emergencies	$70M	1:1	$70M
	Traditional Advance Financing (TAF)	• Loans to projects with forecasted contributions as collateral	TBD	TBD	TBD
Pipeline Management	Forward Purchase Facility (FPF)	• Food purchasing in advance of requests from projects	*Does not require dedicated reserve – is in fact working capital management*		
Capital Financing	Corporate Services (CS)	• Advance financing for corporate services such as vehicle purchases	*Replace dedicated reserve with appropriate risk mitigating measures*		

Summary and Guidance

Emerging recommendations for discussion and consultation

	Description	Rationale
1 Extend collateral acceptable within Traditional Advance Financing	• In additional to medium/high forecasts, include low probability and non donor-specific forecasts as collateral for advance financing	• Increase available collateral for loans from ~30% to 50% of yearly income • Increased impact to beneficiaries • Risk likely to remain low – probability of impacting operational reserve still low
2 Remove dedicated reserve for FPF	• Remove FPF reserve requirement	• FPF is working capital • Risks can be managed in more suitable ways
3 Replace dedicated reserve with appropriate risk mitigating measures for Corporate Services	• Remove Corporate Services reserve requirement and instead apply more appropriate risk mitigations and back-up mechanisms	• Nature of Corporate Services risks allows use of alternative risk mitigation measures
4 Clarify overall framework	• Replace WCFF framework with three distinct mechanisms: – Project lending – Pipeline management – Capital financing	• Three mechanisms are serving very different purposes and have different risk profiles