



Technical Assistance Report

Project Number: 39221
September 2006

Kingdom of Bhutan: Preparing the SME/Microenterprise Development Program: Financing Component (Financed by the Japan Special Fund)

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 11 July 2006)

Currency Unit	–	ngultrum (Nu)
Nu1.00	=	\$0.0217
\$1.00	=	Nu46.145

ABBREVIATIONS

ADB	–	Asian Development Bank
BDFC	–	Bhutan Development Finance Corporation
BNB	–	Bhutan National Bank
BOB	–	Bank of Bhutan
DADM	–	Department of Aid and Debt Management
HR	–	human resources
MIS	–	management information system
MSE	–	micro- and small enterprise
RICB	–	Royal Insurance Corporation of Bhutan
SME	–	small- and medium-sized enterprise
TA	–	technical assistance

TECHNICAL ASSISTANCE CLASSIFICATION

Targeting Classification	–	General intervention
Sectors	–	Finance, industry and trade
Subsectors	–	Microfinance, small- and medium-scale enterprises
Themes	–	Sustainable economic growth, private sector development
Subthemes	–	Developing rural areas, private sector investment

NOTE

In this report, "\$" refers to US dollars.

Vice President	L. Jin, Operations Group 1
Director General	K. Senga, South Asia Department (SARD)
Director	A. Sharma, Governance, Finance, and Trade Division, SARD
Team leader	C. Hu, Economist, SARD
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I. INTRODUCTION

1. During the Country Program Mission in April 2005, the Government of Bhutan (the Government) requested a project preparatory technical assistance (TA) from the Asian Development Bank (ADB) to develop a program for enhancing the financing of small- and medium-sized enterprises (SMEs) under the proposed SME/Microenterprise Development Program: Financing Component.¹ The request is consistent with the Government's efforts to develop the country's private sector. The TA was included in ADB's country strategy and program 2006–2010 for Bhutan.²

2. A fact-finding mission visited Thimphu, Bhutan from 21 March to 1 April 2006 and reached an understanding on the objective, scope, financing plan, and implementation arrangements of the TA with the Government. The TA design and monitoring framework is in Appendix 1, and the initial poverty and social analysis is in Appendix 2.³

II. ISSUES

3. Bhutan's formal private sector is categorized into large, medium, small, and micro/cottage enterprises, based on the initial capital investment category.⁴ Only a handful of medium-sized companies (i.e., 100 employees or more) dominate the formal private sector. Most enterprises (i.e., 97% of all Bhutanese businesses) are micro- and small enterprises with fewer than 10 employees and invested capital of less than Nu5 million. The recent ADB-funded TA for SME development (footnote 1), which assisted the Government in conducting a comprehensive sector assessment to foster private sector development, found that the majority of microenterprises and SMEs face various constraints in their business operations. Limited access to finance is one of the main constraints that hinder the financing of micro- and small enterprise (MSE) development.⁵

4. The financial sector in Bhutan is very small and provides limited financial products and services. There are only two commercial banks—Bhutan National Bank (BNB) and Bank of Bhutan (BOB), and two nonbank financial institutions—Bhutan Development Finance Corporation (BDFC) and Royal Insurance Corporation of Bhutan (RICB). The two commercial banks dominate the financial sector with a market share of 88% in total assets and 76% in total lending. However, BOB lends mainly to government enterprises and BNB mainly to medium and large enterprises or individuals who meet collateral criteria. RIBC and BDFC have a combined market share of 24% of total lending operations.

5. **Bhutan Development Finance Corporation.** BDFC was established in 1988 with assistance from ADB, and equity participation from the Government and other financial institutions (paragraph 7). BDFC is the only development finance institution in Bhutan, and is mandated to provide credit to small- and medium-scale industrial and agricultural activities—particularly in rural areas. As a result, BDFC has (i) the most extensive branch network in the

¹ The project preparatory technical assistance (TA) is complementary to ADB. 2004. *Technical Assistance to the Kingdom of Bhutan for Small and Medium Enterprise (SME) Development*. Manila (TA 4412-BHU).

² ADB. 2005. *Bhutan: Country Strategy and Program Update (2006–2010)*. Manila.

³ The TA first appeared in *ADB Business Opportunities* on 11 April 2006.

⁴ Large enterprises are classified as business investments of more than Nu10 million; medium between Nu5 and Nu10 million; small between Nu1 and Nu5 million; and microenterprises less than Nu1 million.

⁵ Other constraints that hindered business development include (i) cumbersome business start-up process, (ii) limited instruments and capacity to formulate and implement a SME development policy, (iii) lack of capacity of business development services providers, and (iv) inadequate infrastructure.

country except BOB; and (ii) 14,764 active clients in rural areas (17.2% of the total rural households), accounting for over 90% of rural lending in Bhutan (end of 2005). BDFC is the only financial institution with an active role in both rural and MSE lending. According to the 9th Five-Year Plan (2002–2007), Bhutan's overall economic development activities are largely dependent on the growth of SMEs and microenterprises, particularly those that are rural-based. Therefore, BDFC is expected to continue to play an important role in financing Bhutan's development activities and bringing financial services to rural areas. In addition, there is a consistent review on the role of BDFC in recent reports.⁶ BDFC is not yet able to fully fulfill its role as a development bank. Its weaknesses, which have resulted in limited expansion in the rural and MSE lending markets, are detailed below.

6. **Resource Mobilization.** As a nonbank financial institution, BDFC was not allowed to mobilize savings from the public. However, since 2005, it has been entitled to mobilize rural savings on a pilot basis to encourage rural savings. Nonetheless, the main sources of funds are external concessional loans and grants from international agencies such as ADB, International Fund for Agricultural Development, and Kuwait Fund for Arab and Economic Development. Recently, BDFC received a loan of Nu500 million with a 10-year tenor from BOB. Despite this, BDFC's loan portfolio growth projections for the next 5 years already exceed the organization's current funding resources. Therefore, the recent TA for SME Development (footnote 1) recommended a credit line approach to address the lack of medium- to long-term funds—along with preparation and implementation of a new strategy and business plan in which BDFC will be accountable for its performance as a development bank. Furthermore, the TA for SME Development recommended that the new strategy consider expansion of the pilot rural saving scheme to ensure its sustainability and integrate the rural economy into the formal financial system. The proposed interventions are in line with recommendations discussed in earlier reports (footnote 6).

7. **Ownership and Management.** BDFC's initial capital structure consists of Nu100 million paid-up equity shares, of which the Government holds 87%, BOB 7.5%, RICB 3% and BNB 2.5%. BDFC is governed by a board of directors and chaired by the secretary of finance. The board comprises representatives from the Ministry of Finance, Ministry of Trade and Industry, Ministry of Agriculture, Planning Commission, and a representative from a *dzongkhag* (i.e., district) and a *gewog* (i.e., block made of several villages). From the standpoint of good governance, the present structure could benefit from private sector representation. Management consists of (i) the managing director, who is appointed by the Government; and (ii) four general managers, who are responsible for finance, credit operations, branch operations, and central support. In 2003, BDFC revised its strategy with ADB assistance⁷ and developed the 9th five-year business plan (2003–2007). However, the business plan has not been fully implemented or revised during the last 3 years to consider new developments, so it is outdated.

8. **Human Resources.** BDFC has high staff turnover because of its limited benefit structure and inadequate human resources (HR) planning and management. An appropriate benefit and incentive structure should be provided to retain qualified personnel and ensure good staff performance. A human resources development (HRD) division was established in 2003 to obtain and secure sufficient staff through adequate HR management. However, the division has

⁶ ADB. 2005. *Country Assistance Program Evaluation for Bhutan*. Manila; ADB. 2001. *Technical Assistance to the Kingdom of Bhutan for Financial Sector Review*. Manila (TA 3687-BHU); and ADB. 2004. *Technical Assistance to the Kingdom of Bhutan for Small and Medium Enterprises Development*. Manila (TA 4412-BHU).

⁷ ADB. 2002. *Technical Assistance to the Kingdom of Bhutan for Institutional Development of the Bhutan Development Finance Corporation*. Manila (TA 3910-BHU).

limited authority and primarily provides administrative support while the management committee takes all HR and training decisions.

9. **Operational Policies and Procedures.** There is no formal policy for offering differential interest rates based on the client's credit rating, term, or type of lending. BDFC provides term loans with different maximum maturities depending on the sector (e.g., manufacturing for up to 10 years, handicraft/cottage up to 5 years), at an average term of 3.16 years and an average size of about Nu100,000. Branch offices have loan approval authority up to Nu50,000 and regional offices may approve up to Nu100,000; headquarters approves all loans above Nu100,000. Loans are primarily approved on the basis of collateral. Loan officers who are responsible for loan processing lack the relevant skills needed for better management of MSEs and evaluation of MSE risks. As a result, BDFC's provision for nonperforming assets are higher than those of other banks, and its portfolio quality has been affected by (i) weak loan appraisal and monitoring systems, (ii) weak credit risk management, and (iii) inadequate internal control and audit. The portfolio quality will not improve significantly unless a significant change is introduced in these areas.

III. THE TECHNICAL ASSISTANCE

A. Impact and Outcome

10. The overall TA objective is to (i) improve access to finance, (ii) generate income opportunities, and (iii) create jobs for the microenterprise and SME sector—through BDFC's improved performance and greater outreach to MSEs. The TA will support BDFC in enhancing its governance, increasing operational efficiency, and raising institutional capacity with a view to ensuring its sound and stable operation. The TA outcome is an agreed design under the proposed SME/Microenterprises Development Program⁸ focusing on improving BDFC's operations and business development.

11. TA outputs include (i) an improved governance structure; (ii) the design of a new strategy and business plan (2007–2011) for BDFC to ensure that it represents a credible basis for establishing and guiding BDFC's MSE lending operations; and (iii) capacity building support to enable BDFC to implement its business plan, focusing on human resources development, MSE lending techniques, development of demand-oriented products, and other areas as relevant.

B. Methodology and Key Activities

12. The TA will include the following key activities.

13. **Activity 1: Improve Corporate Governance Structure and Operational Policies and Procedures.** The TA will (i) ensure the introduction of private sector representation and implementation of corporate governance as described in the Royal Monetary Authority Prudential Regulations (2002), and (ii) develop appropriate internal control systems at all levels and business areas. The TA will further develop and/or improve policies and procedures, such as general risk management, credit risk management, funding and asset liability management,

⁸ ADB. 2004. The draft final report of TA 4412-BHU for SME Development (i) identified the need for a credit line for microenterprise and SME lending, and further recommended that such an intervention should focus on BDFC; and (ii) identified other assistance to further support business development services, formalize the SME development strategy, and strengthen the legal and regulatory framework.

financial policies including budgeting and internal control, and overall management information system procedures.

14. **Activity 2: Develop a New Strategy and Business Plan.** The TA will develop a new strategy and 5-year business plan (2007–2011) for BDFC, setting out strategic objectives including clear financial and operational performance targets, increased coverage and outreach for MSEs, and an outline of how these should be achieved in a cost-effective way. Additional attention will be brought to the possible expansion of the rural saving scheme to address the external funding issue. The business plan should also include (i) analysis of the external business environment and BDFC's internal capabilities, and (ii) a description of BDFC's key product and services, competition, and potential comparative advantages, using a strengths, opportunities, weakness, and threats (SWOT) analysis. The quality and content of the business plan should make it the key reference for justifying and recommending appropriate measures to the board of directors for better performance of BDFC as a development bank.

15. **Activity 3: Provide Capacity Building to Ensure Implementation of Business Plan.** The TA will provide training to ensure that BDFC has the capability to follow its mandate as specified in its business plan. Capacity building training will be carried out in areas of HR development, MSE lending policies and techniques, product development, and other areas as relevant. The TA will ensure the implementation of the outputs developed and improved under activities 1 and 2.

- (i) **HR development.** The TA will upgrade BDFC's current HR infrastructure and practices and deliver a revised HR function including policies, procedures, and systems. Activities will include: (a) development and/or revision of current HR management practices (e.g., staff recruitment, HR planning, career path management, rewards, and incentives); (b) development of cost-effective and systematic training programs for all staff; and (c) a detailed HR functional description, including objectives, mission, relationships within the overall organization, key performance indicators, and policies governing the HR activities in general and each function in particular.
- (ii) **Product development.** The TA will support the (a) development of demand-oriented financial products for MSEs, (b) product pricing, and (c) development and implementation of marketing activities.
- (iii) **MSE lending techniques.** MSE lending policies, procedures, and operational guidelines will be developed and implemented, including the introduction of cash flow based MSE lending techniques, and overall control and monitoring systems. Training materials will be developed and training of trainers will be conducted during the TA implementation period. These activities will enhance BDFC's capability and enable it to tap into the new potential MSE market.

C. Cost and Financing

16. The total cost of the TA is estimated at the equivalent of \$590,000, of which \$500,000 will be financed by ADB on a grant basis from the Japan Special Fund, funded by the Government of Japan, and the Government will contribute the remaining \$90,000 equivalent in kind as office space and facilities, counterpart staff, and administrative and clerical support. The detailed cost estimates and financing plan are in Appendix 3. The Government has been informed that approval of the TA does not commit ADB to finance any ensuing project.

D. Implementation Arrangements

17. The Department of Aid and Debt Management (DADM) at Ministry of Finance will be the Executing Agency. BDFC will be the Implementing Agency. A project steering committee consisting of representatives from DADM, Ministry of Trade and Industry, Royal Monetary Authority, and BDFC will be established and meet on a quarterly basis to facilitate project coordination. The project preparatory TA will be implemented during an 18-month period starting in October 2006 and ending in March 2008. Counterpart staff will be nominated from DADM and BDFC, and will work closely with TA consultants to ensure timely and effective TA implementation.

18. ADB will engage three international consultants for a total of 15 person-months and one national consultant for a total of 12 person-months to provide the required consulting services. Consulting services will be delivered intermittently over 18 months. An international consulting firm will be engaged by ADB, using simplified technical proposals under the quality- and cost-based selection method, in accordance with the *Guidelines on the Use of Consultants*. The identified consultants will have experience working in the above-mentioned areas in small economies, with exposure in the South Asia region. The international consultant team will comprise a development banking/MSE specialist/team leader (8 person-months), HR development expert (2 person-months), and MSE lending specialist (5 person-months). The national consultant will be a MSE lending/training specialist (12 person-months). The consultant team will be responsible for organizing workshops and providing training to counterpart staff as required. The outline terms of reference for consultants are in Appendix 4.

19. The consultants will prepare (i) an inception report within 21 days of their fielding; (ii) a new strategy and business plan (2007–2011) for BDFC 3 months after fielding (i.e., by January 2007); (iii) a first progress report 6 months after fielding; (iv) a second progress report 12 months after fielding; (v) a draft final report to be submitted 3 weeks before the end of the consulting term; and (vi) a final report at the end of the consulting assignment.

20. At least two tripartite meetings will be held to discuss the strategy and business plan (2007–2011) for BDFC and other relevant project reports. All reports will be submitted (in hard and soft copies) to the Government and ADB for review and comments. Consultants will incorporate the comments received while finalizing the reports. The reports shall be made available 2 weeks from the date of the tripartite meetings and/or receipt of comments.

IV. THE PRESIDENT'S DECISION

21. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$500,000 on a grant basis to the Government of Bhutan for preparing the SME/Microenterprise Development Program: Financing Component, and hereby reports this action to the Board.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<p>Impact Improved access to finance, better income-generating opportunities, and greater job creation for micro- and small enterprises (MSEs)</p>	<p>Increased share of MSE lending via Bhutan Development Finance Corporation (BDFC)</p> <p>Improved operations and capacity of BDFC to reach out to rural areas</p> <p>Better and more demand-oriented products suitable for MSEs</p>	<p>Royal Monetary Authority annual reports</p> <p>BDFC annual reports</p> <p>Asian Development Bank (ADB) review mission</p> <p>ADB reports and documents</p>	<p>Assumptions</p> <ul style="list-style-type: none"> • Program is implemented • The Government and ADB sign the loan agreement on the Small- and Medium-Sized Enterprise (SME)/Microenterprise Program <p>Risk</p> <ul style="list-style-type: none"> • Lack of specific mechanism for monitoring program effectiveness
<p>Outcome The agreed design for the financing component of the SME/ Microenterprise Development Program, focusing on enhancing BDFC's capability in MSE lending</p>	<p>Level of disbursement of credit facility to target MSEs</p>	<p>Memorandum of understanding signed by the Government during appraisal mission for sector development program loan in March 2007</p>	<p>Assumptions</p> <ul style="list-style-type: none"> • Full cooperation and participation by the Government, BDFC, and other relevant stakeholders during project preparatory stage • The Government agrees on program design <p>Risks</p> <ul style="list-style-type: none"> • Low commitment by the Government and relevant stakeholders, including BDFC, to reform • Insufficient financial resources for policy implementation
<p>Outputs 1. Improved corporate governance structures and operational policies and procedures</p>	<p>New and improved corporate governance structure and supporting policies and procedures</p>	<p>BDFC annual reports</p> <p>Technical assistance (TA) progress reports</p> <p>ADB review missions</p>	<p>Assumptions</p> <ul style="list-style-type: none"> • Strong commitment of BDFC management and staff • Recruited consultants, the Government, and BDFC work cohesively

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<p>2. A new strategy and 5-year business plan (2007–2011) for BDFC to ensure that it represents a credible basis for establishing and guiding BDFC's MSE lending operations</p> <p>3. Strengthened institutional capacity building for BDFC to implement its business plan, focusing on human resources (HR) development, MSE lending techniques, development of demand-oriented products, and other areas as relevant.</p>	<p>Development of appropriate internal control systems and other operational procedure and policies by June 2007</p> <p>A new strategy and business plan prepared by January 2007, and approved by BDFC's board of directors by June 2007</p> <p>Training courses conducted in focus areas</p>	<p>Tripartite meeting minutes</p> <p>BDFC annual reports</p> <p>ADB review missions</p> <p>Feedback from trainees and stakeholders</p> <p>BDFC annual reports</p> <p>TA progress reports</p> <p>ADB review missions</p>	<p>Risks</p> <ul style="list-style-type: none"> • BDFC Management lacks will to cooperate and reform • BDFC's low commitment to capacity building and inadequate allocation of financial resources for new strategy and business plan implementation
<p>Activities with Milestones</p> <p>Activity 1: Improve Corporate Governance Structure and Operational Policies and Procedures</p> <p>1.1 Implement corporate governance as described in the Royal Monetary Authority Prudential Regulations (2002) (by March 2008).</p> <p>1.2 Develop internal control systems at all levels and business areas. Further develop/improve and implement procedures and policies, such as general risk management, credit risk management, funding and asset liability management, financial policies including budgeting and internal control, and overall management information system procedures (development by January 2007 and implementation by March 2008).</p> <p>Activity 2: Develop a New Strategy and Five-Year Business Plan</p> <p>2.1 Develop a new strategy and 5-year business plan (2007–2011) for BDFC, setting out the strategic objectives, including clear financial and operational performance targets, increased coverage and outreach for MSEs, and an outline of how these should be achieved. The quality and content of the business plan should make it the key reference for justifying and recommending appropriate measures to BDFC's board of directors for better performance of BDFC as a development bank (by January 2007).</p> <p>2.2 Conduct (i) analysis of the external business environment and BDFC's</p>			<p>Inputs</p> <p>ADB: \$500,000</p> <ul style="list-style-type: none"> • Consulting services (27 person-months): \$416,000 • Training: \$15,000 • Survey: \$16,000 • Miscellaneous and contingency: \$53,000 <p>Government: \$90,000</p> <ul style="list-style-type: none"> • Office and secretarial support: \$35,000 • Counterpart support: \$45,000 • Reports and communications: \$5,000 • Contingency: \$5,000

Activities with Milestones	Inputs
<p>internal capabilities; and (ii) a description of its key products/services, competition, and potential comparative advantages, using a strengths, opportunities, weakness, and threats (SWOT) approach (by January 2007).</p> <p>Activity 3: Provide Capacity Building to Ensure Implementation of Business Plan. The TA will provide training to ensure that BDFC has the capability to follow its mandate as specified in its business plan. This capacity building training will be in (i) HR development, (ii) product development, and (iii) MSE lending techniques.</p> <p>3.1 Develop and/or revise current HR management practices (e.g., staff recruitment, HR planning, career path management, rewards, and incentives). Develop cost-effective and systematic training programs for all staff. Prepare a detailed HR functional description, including objectives, mission, relationships within the overall organization, key performance indicators, and policies governing HR activities in general and each functions in particular (by January 2007).</p> <p>3.2 Develop demand-oriented financial products for MSEs, including appropriate product pricing, and development and implementation of marketing activities (commencing January 2007, development by May 2007, and implementation by March 2008).</p> <p>3.3 Develop and implement MSE lending policies, procedures, and operational guidelines, including the introduction of cash flow based MSE lending techniques, and overall control and monitoring systems. Develop training materials and conduct training of trainers during the TA implementation period to enhance BDFC's capability and enable it to tap into the new potential MSE market (commencing June 2007 and completed by March 2008).</p>	

INITIAL POVERTY AND SOCIAL ANALYSIS

A. Linkages to the Country Poverty Analysis

Is the sector identified as a national priority in country poverty analysis?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Is the sector identified as a national priority in country poverty partnership agreement?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
<p>Contribution of the sector or subsector to reduce poverty in Bhutan:</p> <p>The private sector is identified as the engine of economic growth in view of achieving the development goals of the 9th Five-Year Development Plan (2002–2007). As 95% of the private sector is composed of microenterprises and small- and medium-sized enterprises (SMEs), SME development is vital to fostering economic growth, creating employment opportunities, and reducing poverty. However, the SME/private sector has not yet become the engine of economic growth or poverty reduction in Bhutan because of (i) small-sized domestic markets, (ii) lack of labor, (iii) underdeveloped infrastructure, and (iv) lack of adequate access to finance. The Government recognized the urgent need to further promote private sector development and increase SME business opportunities.</p> <p>It is estimated that 70,000 new graduates will enter the labor market each year. While public sector employment opportunities are limited, the private sector—particularly SMEs—is expected to play a greater role in absorbing the growing youth and educated population in Bhutan. The program will support the Government’s strategy in promoting private sector/SME development through increasing financial access, providing business development services, and enhancing SME policy formulation and relevant legal and regulation framework. It is expected that market-based finance and better business support services will be provided to the private sector, resulting in an increase of private sector credits as a percentage of total financial assets to more than the current 20% level; and a growth in private sector contribution (in the manufacturing, trade and commerce, and services sectors) as a percentage of gross domestic product from the current 34% level.</p>			

B. Poverty Analysis

Targeting Classification: General intervention

<p>What type of poverty analysis is needed?</p> <p>There is an increasing number of new entrants to the labor market but the expansion of the industrial sector is currently insufficient to absorb the labor force. As such, the importance of developing the private sector, particularly microenterprises and SMEs, is increasing in terms of job creation and further economic growth by transforming Bhutan’s economy from a subsistence-based to a more modern and productive one. Most microenterprises and SMEs are located in rural areas. The social and poverty impact of developing the private sector will be analyzed while recommending the policy and reform program for SME/microenterprise development.</p>
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C. Participation Process

Is there a stakeholder analysis?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
<p>Full consultation will be held among relevant stakeholders, including the Bhutan Development Finance Corporation (BDFC), Ministry of Finance (MOF), Ministry of Trade and Industry, Royal Monetary Authority, and other relevant multilateral and bilateral organizations.</p>		
Is there a participation strategy?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
<p>During implementation of the technical assistance (TA), there will be two or more workshops and training sessions. The workshops and training will ensure active participation and full communication of key players in further developing the private sector.</p>		

D. Gender Development

Strategy to maximize impacts on women: None. However, the program will improve knowledge about female entrepreneurship and its socioeconomic role. Knowledge regarding financing of women-owned business will be improved by strengthening BDFC's institutional structure for SME lending, policy reforms, and better business development services.

Has an output been prepared? Yes No

E. Social Safeguards and Other Social Risks

Item	Significant/ Not Significant/ None	Strategy to Address Issues	Plan Required
Resettlement	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	Not applicable.	<input type="checkbox"/> Full <input type="checkbox"/> Short <input checked="" type="checkbox"/> None
Affordability	<input type="checkbox"/> Significant <input checked="" type="checkbox"/> Not significant <input type="checkbox"/> None	Better access to credit, including development of demand-oriented products and proper pricing, will improve the affordability and competitiveness of the SME sector.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Labor	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	A positive labor impact is expected resulting from extended credit outreach and more economic opportunities.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Indigenous Peoples	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	Not applicable.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Other Risks and/or Vulnerabilities	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	Any social risk or vulnerabilities will be monitored in the course of TA implementation.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Total Cost
A. Asian Development Bank Financing^a	
1. Consultants	
a. Remuneration and Per Diem	
i. International Consultants	320.0
ii. National Consultants	48.0
b. International and Local Travel	45.0
c. Reports and Communications	3.0
2. Training, Workshops, including Manuals	15.0
3. Research and Survey Expenses	16.0
4. Miscellaneous Administration and Support Costs	3.0
5. Contingencies	50.0
Subtotal (A)	500.0
B. Government Financing	
1. Office, Secretarial, and Related Services	35.0
2. Counterpart Support	45.0
3. Reports, Workshops, and Communications	5.0
4. Contingencies	5.0
Subtotal (B)	90.0
Total	590.0

^a Financed by the Japan Special Fund, funded by the Government of Japan.
Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

A. International Consultants

1. Development Banking/Micro- and Small Enterprises (MSE) Specialist/Team Leader (8 person-months)

1. The expert must have extensive experience in designing, monitoring, and implementing strategy, policy, and business planning for development finance institutions. He or she should have a degree in development economics, business administration, or a related field with evidence of further qualification in banking operations. At least 15 years of operational banking experience is required, of which at least 10 years should be actual operational experience at senior level positions of development banking/microfinance, preferably in the South Asia region. A good understanding and knowledge of Bhutan's economy and financial market would be an advantage. The expert should also have good information-sharing skills in order to communicate with the counterpart staff and team members, conduct workshops and meetings, and provide on-the-job training. The tasks and responsibilities of the expert will include the following:

- (i) Develop and assist in initial implementation of the new strategy and business plan (2007–2011) for Bhutan Development Finance Corporation (BDFC), setting out strategic objectives, including clear financial and operational performance targets, increased coverage and outreach for MSEs, and an outline of how these should be achieved in a cost-effective way. The business plan should also include (a) analysis of the external business environment and the internal capabilities of BDFC; and (b) a description of its key products/services, competition, and potential comparative advantages with a strengths, weaknesses, opportunities, and threats (SWOT) analysis. The quality and content of the resulting business plan should make it the key reference for justifying and recommending measures to BDFC's board of directors for better performance and greater operational efficiency of BDFC as a development bank.
- (ii) Help set up a corporate planning group within BDFC that will implement strategic plans and continue to develop BDFC's strategic planning capacity.
- (iii) Review the current saving manual and provide recommendations for changes, where necessary, with a view to addressing the external funding issue through possible expansion of the rural saving scheme.
- (iv) Review, develop, and implement policies and procedures in (a) funding and asset liability management; (b) general risk management covering, but not limited to, operational risk, liquidity risk, and foreign exchange risk, where relevant; (c) credit risk management; (d) financial policies, including budgeting and internal control; and (e) overall management information system (MIS) procedures.
- (v) Provide on-the-job training in (iv) in close coordination with the national MSE lending/training specialist; and further develop the following documents for training and operational purposes: (a) asset liability management manual, (b) operational risk management manual, (c) financial manuals covering budget and internal control, and (d) overall MIS procedures.

- (vi) Review, develop, and implement internal control systems at all levels and business areas, e.g., at branch levels/*dzongkhag* (i.e. district) and *gewog* (i.e. block made up of several villages).
- (vii) Include the new human resources (HR) strategy in BDFC's new business plan (2007–2011), with the input of the international HR development specialist, and implement its recommendations and subsequent related HR procedures.
- (viii) Work together with other team members to conduct discussions with the Government and relevant stakeholders for information collection and dissemination.
- (ix) Oversee and advise on the overall work of the technical assistance (TA), and prepare reports satisfactory to counterparts and the Asian Development Bank (ADB). Particularly, the team leader, with the support of team members, should provide the necessary information, analysis, and/or appendixes for meeting reporting requirements of ADB program processing, focusing on the financing component of the small- and medium-sized enterprises (SME)/Microenterprises Development Program.

2. Human Resources Development Expert (2 person-months)

2. The expert should have at least 10 years of extensive and practical working experience of human resources development (HRD) at a commercial bank or well-known financial institution. He or she should have a degree in business administration or a related field with evidence of further qualification in HRD. Working experience and knowledge of South Asia—particularly understanding of Bhutan's history, culture, and society or a similar society in the South Asian region—is preferred. The tasks and responsibilities of the expert will include the following:

- (i) Review current human resources (HR) practices (policies and procedures) such as staff recruitment, HR planning, and employee reward and incentive system at BDFC.
- (ii) Develop and/or revise a detailed functional description for every HR activity, including relevant HR guidelines, procedures, and policies. Activities will include (a) development and/or revision of current HR management practices (e.g., staff recruitment, HR planning, career path management, rewards, and incentives); (b) development of cost-effective and systematic training programs for all staff; and (c) a detailed HR functional description, including objectives, mission, relationships within the overall organization, key performance indicators, and policies governing HR activities in general and each function in particular.
- (iii) Develop or align new procedures in view of the new organization, devised functions, and approved policies. Review legal, operational, and financial consequences of the new procedures, where needed.
- (iv) Propose training requirements, professional criteria for management, and operational staff at BDFC's headquarters and branch level.
- (v) Conduct training sessions for disseminating and implementing the new HR strategy and policy, and its subsequent requirements.

- (vi) Provide support to the team leader to prepare reports as required by the TA and also for ADB program processing as discussed in (1)-(ix).

3. MSE Lending Specialist (5 person-months)

3. The expert should have at least 10 years of demonstrated experiences in cash flow based lending, micro- and small loan/lease appraisal, supervision, and monitoring technology. He or she should have good practical knowledge in development economics and banking management, particularly in financial institutions and/or banking systems in the South Asian region. Knowledge of Bhutan's financial system will be an advantage. The tasks and responsibility of the expert will include the following:

- (i) Review current credit manual, portfolio of products and services, and efficiencies of existing network of mobile outlets and branches locations.
- (ii) Streamline and strengthen MSE credit approval procedures and management practices, including preparing a quick reference guide and/or credit manual to assist BDFC's credit officers to prepare realistic project appraisal reports on different projects.
- (iii) Prepare branch operational manuals, in close coordination with the team leader, relating to (a) general risk management covering, but not limited to, operational risk and liquidity risk; (b) credit risk management; (c) overall internal control and monitoring systems; (d) MIS procedures; and (e) other related areas as necessary, as shown in (1)-(iv); and provide training in the above areas, as required.
- (iv) Develop training materials and case studies in close coordination with the national MSE lending/training specialist, and train BDFC staff in best practices for micro- and small loan/lease appraisal, and supervision and administration skills (i.e., introduction of suitable cash-based MSE lending techniques).
- (v) Strengthen BDFC's marketing of micro- and small loans/lease financing.
- (vi) Estimate demand for new, demand-driven products; and conduct survey.
- (vii) Develop demand-oriented financial products for MSEs, including appropriate product pricing, and development and implementation of marketing activities.
- (viii) Provide support to the team leader to prepare reports as required by the TA and also for ADB program processing as discussed in (1)-(ix).

B. National Consultant

1. MSE Lending/Training Specialist (12 person-months)

4. The specialist should have background training in financial sector development and practical working experience in MSE lending and microfinance operations. He or she should have a good understanding of Bhutan's financial sector development, and related rules and regulations. The specialist must possess good information sharing skills to conduct training sessions and meetings. Proficiency in English is necessary, and working experience with international consulting

firms, multi-donor organizations, and/or the Government is preferred. The task and responsibilities will include the following:

- (i) Collect and analyze financial information and data, under the guidance of the team leader and in coordination with the international consultants, and further review the current bookkeeping practice for loans and deposits at *gewog* (i.e., block made up of several villages) and *dzongkhag* (i.e., district) levels, as required.
- (ii) Assist the team leader and international HR development expert in developing and delivering the new strategy and 5-year business plan for BDFC.
- (iii) Conduct training and workshops at branch levels to BDFC staff with a view of implementing the new strategy and business plan (2007–2011), and adopting the new HR policy, MSE lending techniques, and demand-oriented products.
- (iv) Assist logistic arrangements for the team to travel within the country as necessary.
- (v) Assist the team leader in collecting information and preparing reports satisfactory to counterparts and ADB for meeting reporting requirements of ADB program processing, focusing on the financing component of the SME/Microenterprise Development Program.
- (vi) Assist the team leader and international consultants in preparing materials for workshops and roundtable discussions, including translation of documents and interpretation in workshops/roundtable discussions.