



# Report and Recommendation of the President to the Board of Directors

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Project Number: 51269-001  
October 2018

## Proposed Loan and Technical Assistance Grant People's Republic of Bangladesh: Microenterprise Development Project

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Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 22 October 2018)

Currency unit	–	taka (Tk)
Tk1.00	=	\$0.0119
\$1.00	=	Tk83.895

## ABBREVIATIONS

BFP-B	–	Business Finance for the Poor in Bangladesh
FID	–	Financial Institutions Division
MFI	–	microfinance institution
MRA	–	Microcredit Regulatory Authority
PAM	–	project administration manual
PIU	–	project implementation unit
PKSF	–	Palli Karma Sahayak Foundation
PO	–	partner organization
SMEs	–	small and medium-sized enterprises
TA	–	technical assistance

## NOTES

- (i) The fiscal year (FY) of the Government of Bangladesh and its agencies ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2018 ends on 30 June 2018.
- (ii) In this report, “\$” refers to United States dollars.

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## PROJECT AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number:</b> 51269-001	
<b>Project Name</b>	Microenterprise Development Project	<b>Department /Division</b>	SARD/SAPF
<b>Country Borrower</b>	BAN Bangladesh	<b>Executing Agency</b>	Ministry of Finance
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Finance</b>	Inclusive finance		50.00
		<b>Total</b>	<b>50.00</b>
<b>3. Strategic Agenda</b>	<b>Subcomponents</b>	<b>Climate Change Information</b>	
Inclusive economic growth (IEG)	Pillar 2: Access to economic opportunities, including jobs, made more inclusive	Climate Change impact on the Project	Low
<b>4. Drivers of Change</b>	<b>Components</b>	<b>Gender Equity and Mainstreaming</b>	
Governance and capacity development (GCD)	Institutional development	Gender equity (GEN)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
Partnerships (PAR)	Civil society organizations Foundations Implementation Private Sector		
Private sector development (PSD)	Promotion of private sector investment		
<b>5. Poverty and SDG Targeting</b>		<b>Location Impact</b>	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG5, SDG8		
<b>6. Risk Categorization:</b>	Low		
<b>7. Safeguard Categorization</b>	<b>Environment: FI-C Involuntary Resettlement: FI-C Indigenous Peoples: FI-C</b>		
<b>8. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>50.00</b>	
Sovereign Project (Regular Loan): Ordinary capital resources		50.00	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>12.50</b>	
Others		12.50	
<b>Total</b>		<b>62.50</b>	
Note: An attached technical assistance will be financed on a grant basis by the Financial Sector Development Partnership Special Fund in the amount of \$500,000.			
<b>Currency of ADB Financing:</b> USD			



## I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the People's Republic of Bangladesh for the Microenterprise Development Project. The report also describes proposed technical assistance (TA) for the Capacity Development for Microenterprise Development Project, and if the Board approves the proposed loan, I, acting under the authority delegated to me by the Board, approve the TA.

2. The project aims to promote microenterprise development for inclusive economic growth and poverty reduction. It will support improving microenterprise access to finance through the Palli Karma Sahayak Foundation (PKSF), an apex development finance and capacity building organization; and its partner organizations (POs), which are selected microfinance institutions (MFIs). The overall project comprises (i) a financial intermediary loan of \$50 million for a credit line to the PKSF and (ii) a TA grant of \$500,000 for building capacity for microenterprise development.

## II. THE PROJECT

### A. Rationale

3. Bangladesh's economy has been growing at an average 6% during 2000-2017. However, poverty is still prevalent—especially in rural areas—and about 24% of the population still lives below the national poverty line. Promoting the rural nonfarm segment became an important policy agenda to generate rural job opportunities and reduce poverty.<sup>1</sup> Bangladesh has a mature microfinance industry, which has been financing the rural nonfarm segment, including microenterprises.<sup>2</sup> Microfinance is now a major funding source for microenterprises and has great potential to contribute to rural nonfarm segment-led growth in Bangladesh.

4. **Microfinance industry in Bangladesh.** Microfinance is defined as financial services, including savings and credit, to poor or low-income people who have no access to formal financial services. Bangladesh's microfinance industry started in the 1970s to reduce poverty by providing microcredit, mainly for rural nonfarm activities. Early pioneer MFIs, including Grameen Bank and BRAC, provided loans based on a group guarantee using funding provided by the Government of Bangladesh, development partners, and donors.

5. Today, Bangladesh's microfinance industry has an extensive outreach of 758 MFIs servicing 30 million clients.<sup>3</sup> The industry is regulated by the Microcredit Regulatory Authority (MRA) under the Microcredit Regulatory Authority Act, 2006. In 2017, MFIs disbursed with total loans outstanding of Tk770 billion. The industry maintains a good portfolio and had a 98% recovery rate in 2017.<sup>4</sup>

6. Traditionally, MFIs provide group-based microcredit to their members to finance cottage-size rural income-generating activities. However, as Bangladesh's economy grows, MFI client

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<sup>1</sup> The rural nonfarm segment is defined as economic activities in villages, rural towns, and peri-urban areas, excluding the primary production of crops, fish, trees, and livestock. Developing the rural nonfarm segment contributes to poverty reduction by fostering backward and forward linkages and creating jobs.

<sup>2</sup> Bangladesh has no unified definition of microenterprises. For this project, a microenterprise is defined as a business entity with investment of Tk40,000–Tk1.5 million, excluding land and buildings used by the enterprise.

<sup>3</sup> The share of female entrepreneurs is estimated to comprise about 29% and 56% of the manufacturing and agribusiness sectors, respectively.

<sup>4</sup> Credit and Development Forum. 2017. *Bangladesh Microfinance Statistics, 2016-17*. Dhaka.

demand is gradually shifting from traditional microcredit to larger loans for nonfarm enterprises (microenterprise loans). In 2010, the MRA developed rules for MFIs on providing microenterprise loans: loans below Tk50,000 are defined as microcredit, while loans above Tk50,000 but below Tk1 million are considered microenterprise loans. In 2017, MFIs provided microenterprise loans to 3.6 million members with total loans outstanding of Tk239 billion. Microenterprise loans comprise more than 31% of the total microfinance industry portfolio.

7. **Microenterprises and their challenges.** Microenterprises in Bangladesh are smaller than small and medium-sized enterprises (SMEs), and the size of their investments is too large for traditional microcredit but too small for bank financing.<sup>5</sup> Microenterprises can promote private sector-led rural economic growth by developing forward linkages and creating self- and wage-employment opportunities, but they face nonfinancial and financial constraints. Nonfinancial constraints include lack of infrastructure facilities and utilities, and inflexible regulations.<sup>6</sup> The financial constraint of limited access to finance is by far the greatest constraint in developing microenterprises in Bangladesh.<sup>7</sup> In addition, women microentrepreneurs face a different set of financial and nonfinancial constraints, including lack of (i) business management skills, (ii) entrepreneurial and technical skills, (iii) start-up finance, (iv) information and access to networking support, and (v) self-confidence.

8. Microenterprises are financed largely by informal sources such as individual savings and informal loans from friends and relatives. Institutional credit can play a role, but it has until recently been marginal. The share of own funds in total microenterprise investments is about 85%, the share of banks is 4%, and MFI financing is 11% in 2015. The overall microenterprise loan demand–supply gap was about Tk437 billion in 2015.<sup>8</sup>

9. Banks and MFIs can be microenterprise financing sources. However, banks are unlikely to be a major source, because of (i) banks' limited knowledge and risk assessment capacity on microenterprises, (ii) banks' limited rural branch network and outreach, (iii) banks' preference for large industrial loans and the high cost of servicing microenterprise loans, and (iv) microenterprises' difficulty in securing valid loan collateral.

10. While MFIs can be a major source of financing for microenterprises, MFIs' microenterprise loans are not keeping pace with demand because of (i) MFIs' limited funding sources, (ii) the limited enabling environment for MFIs' microenterprise operations, and (iii) MFIs' insufficient knowledge and capacity on microenterprise lending.

11. MFIs depend on donor grants or loans, member savings, and retained earnings as funding sources; and do not have sufficient access to other long-term funding. Most MFIs, especially small and medium-sized MFIs, have difficulty mobilizing commercial funding sources because of (i) high

<sup>5</sup> Bangladesh Bank defines SME loans as loans from Tk50,000 to Tk5 million. For this project, a loan below Tk1 million is considered a microenterprise loan and a loan from Tk1 million to Tk5 million is an SME loan.

<sup>6</sup> For nonfinancial constraints, the government's strategies include, among others, creating an enabling environment focusing on infrastructure, rural electrification, gas connection, better physical and electronic communication services, education, training and skills formation, technological upgrading, access to market and business development services. Government of Bangladesh, Planning Commission. 2013. *National Sustainable Development Strategy (2010–2021)*. Dhaka.

<sup>7</sup> Business Finance for the Poor in Bangladesh (BFP-B). 2017. *Diagnostics of Micro-enterprise Lending by MFIs in Bangladesh: Opportunities and Challenges*. Dhaka. BFP-B is a program funded by the Department for International Development of the United Kingdom. The study is based on 600 microenterprises that may or may not be borrowing from MFIs.

<sup>8</sup> BFP-B. 2017. *Diagnostics of Micro-enterprise Lending by MFIs in Bangladesh: Opportunities and Challenges*. Dhaka.

commercial borrowing costs, (ii) MFIs' insufficient risk management and financial reporting capacity, and (iii) commercial lenders' lack of knowledge on microfinance and perceived high risk.

12. **Palli Karma Sahayak Foundation.** To meet MFIs' funding needs, the government set up the PKSf in 1990 as a microfinance wholesaler that provides loans to POs. The PKSf is registered as a not-for-profit company under the Companies Act, 1994 (Act No. 18) for poverty alleviation through sustainable employment generation. It has 277 POs with loans outstanding of Tk44 billion in 2017, while loan disbursement totaled Tk31 billion and net income totaled Tk1.9 billion in 2017. The PKSf has been an important funding source for small and medium-sized MFIs. Its cumulative loan recovery rate was 99.34% at the end of FY2017.<sup>9</sup>

13. In 2017, client savings, retained earnings, and other funds comprised 77% of total MFI funding, followed by loans from commercial banks (16%) and the PKSf (5%). Funding from other sources, including donor funds and other grants, has been declining substantially and made up only 2% of total MFI funding (footnote 4). MFIs are allowed by the MRA to mobilize only member savings and not public deposits. The MRA Rules (2010) also impose caps on MFIs' microenterprise loan volume and the mobilization of member savings. MFI operational guidelines are not fully adequate for microenterprise loans, and many MFIs have limited capacity to provide such loans.

14. In 2001, the PKSf started a microenterprise program to enable its POs to lend to members who have graduated from microcredit and need higher capital for investments. Under the program, any business with an investment up to Tk1.5 million, excluding land and buildings, is considered a microenterprise.<sup>10</sup> The PKSf reported that demand for microenterprise loans has been steadily growing. The number of microenterprise loan end-borrowers from PKSf POs increased from 189,528 in 2010 to 1.15 million at the end of 2017, of whom 70% are women. As of July 2017, the PKSf had cumulatively disbursed more than Tk405 billion in microenterprise loans to POs, with current loans outstanding of Tk13 billion. PKSf disbursements to POs under the microenterprise program totaled Tk7.5 billion in FY2017.

15. With current funding levels, however, the PKSf and its POs can meet only part of their existing members' demand. The PKSf estimates that 2.4 million members of existing POs are eligible for microenterprise loans. The current average microenterprise loan size to end-borrowers is Tk95,000 and is likely to increase as borrowers' investment size grows. The PKSf projects that POs' microenterprise loan demand for 2018–2022 would total Tk107 billion, but its internal onlending resources would be limited to Tk74 billion. This means the PKSf needs at least Tk33 billion for 2018–2022 just to meet existing POs' microenterprise loan demand.<sup>11</sup> Thereby, this project would contribute approximately 13% of PKSf's funding gap.

16. **Proposed solution.** The government considers the PKSf's access to affordable long-term funding as indispensable to solving microenterprise financing constraints. ADB will provide a loan to ease mostly short-term microenterprise financing. The loan will be provided to the PKSf for lending to POs based on eligibility criteria for further sub-lending to microenterprises.

17. The project design takes into account lessons from related ADB operations which highlight the need to strengthen subproject performance monitoring and risk management measures, and

<sup>9</sup> Palli Karma Sahayak Foundation. <http://www.pksf-bd.org>.

<sup>10</sup> The PKSf has its own definition for microenterprises, but MFIs normally identify microenterprises by loan size.

<sup>11</sup> For 2010–2017, the PKSf's microenterprise loan disbursement grew 20% per year on average. With external sources of funding, the PKSf estimates microenterprise loan demand to grow 33% per year during 2018–2022.

emphasizes support for female entrepreneurs (footnote 16). For medium- to long-term solutions, the project will assist the PKSF and its POs in enhancing their capacity in microenterprise lending and promoting sustainable operations (para. 23). Through the attached TA, the project will support the PKSF and its POs in expanding MFIs' microenterprise development services (para. 35). The project will also espouse gender equity and target a loan portfolio with at least 70% women borrowers (paras. 21, 43).

18. **Value added by ADB assistance.** The project's key value addition is to transform PKSF and POs towards a more market oriented financing institutions. MFIs are rapidly expanding their microenterprise portfolios but lack essential skills to make enterprise loans. The size of microenterprise loans is considerably larger than traditional microcredit; and MFIs need to be equipped with appropriate risk assessment, credit appraisal, and financial management skills for microenterprise finance. The project will also strengthen MFIs' environmental and social safeguard monitoring by installing an environmental and social screening system at the PKSF and its POs. Furthermore, the project will bring a technology innovation in POs by introducing a pilot mobile-based microenterprise financing application (para. 24).

19. **Alignment of the Government and ADB Strategies.** The project is aligned with the government's National Sustainable Development Strategy, 2010-2021, which promotes micro, small, and medium-sized enterprise to generate job opportunities.<sup>12</sup> ADB's country partnership strategy for Bangladesh, 2016–2020 identifies improving rural livelihoods and expanding employment opportunities as key priority areas.<sup>13</sup> The project is based on ADB's successful experience in microfinance and SMEs, including projects with the PKSF.<sup>14</sup>

## B. Impact and Outcome

20. The project is aligned with the following impact: growth of microenterprises expanded to provide forward linkages to agriculture and generate job opportunities.<sup>15</sup> The project will have the following outcome: microenterprises' access to MFI financing increased.<sup>16</sup>

## C. Outputs

21. **Output 1: Funding to microfinance institutions for microenterprise loans expanded.** This output will provide a credit line to the PKSF for onlending to POs to ease short-term microenterprise financing constraints. It aims to provide loans to 40,000 microentrepreneurs, of whom 70% are female.<sup>17</sup> The typical onlending rate is 5.0%–7.5% per year from the PKSF to POs

<sup>12</sup> Government of Bangladesh, Planning Commission. 2013. *National Sustainable Development Strategy (2010–2021)*. Dhaka.

<sup>13</sup> ADB. 2016. *Country Partnership Strategy: Bangladesh, 2016–2020*. Manila.

<sup>14</sup> ADB projects for micro, small, and medium-sized enterprises in Bangladesh include the (i) ADB. 2009. *Grant Assistance Report: Proposed Grant Assistance to the People's Republic of Bangladesh for Developing Inclusive Insurance Sector Project*. Manila; (ii) ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of Bangladesh for the Small and Medium-Sized Enterprise Development Project*. Manila; and (iii) ADB. 2016. *Report and Recommendation of the President to the Board of Directors: Proposed Loan and Administration of Technical Assistance Grant to the People's Republic of Bangladesh for the Second Small and Medium-Sized Enterprise Development Project*. Manila.

<sup>15</sup> Government of Bangladesh, Planning Commission. 2013. *National Sustainable Development Strategy (2010–2021)*. Dhaka.

<sup>16</sup> The design and monitoring framework is in Appendix 1.

<sup>17</sup> The project will finance various types of microenterprise mainly in agriculture, manufacturing, processing and service sectors. Examples of microenterprises include milk production, light manufacturing, food processing, retail shops and transport services.

and about 25.0% per year from POs to end-borrowers.<sup>18</sup> The regulatory interest rate cap on MFIs is 27% per year in Bangladesh. The project will make sure that the POs have onlending rates that are adequate to cover all costs and risks associated with onlending, have an adequate margin, and comply with MRA regulations.

22. To address medium-term financing constraints, the output will support the development of a medium-term institutional strengthening and financing strategy for the PKSF. The strategy will include enhancing the PKSF's policies, risk assessment, due diligence, and financial and portfolio management and monitoring; and assessing the feasibility of diversifying funding sources.

23. **Output 2: Microfinance institutions' capacity in microenterprise lending enhanced.** The output will enhance MFI capacity in microenterprise lending by improving microenterprise finance operational guidelines for MFIs. The guidelines will have methodologies for credit appraisal, pricing, terms and conditions, and financial and portfolio management and monitoring of MFIs' microenterprise finance operations, including risk management. Improvement of the guidelines will be followed by training for the PKSF's POs.

24. For selected POs, a pilot mobile-based microenterprise financing application will be implemented for activities such as loan application, appraisal, disbursement, and collection. For the pilot project, support will include legal and regulatory consultation, application development or adoption, guidelines and manual development, and PO and client training.

25. **Output 3: Microfinance institutions' microenterprise development support extended.** The output will support microenterprises' access to wider and upscale markets. It will identify promising microenterprise products for potential expansion and support microenterprise cluster development by assisting in quality control, branding, packaging, and marketing.<sup>19</sup> Priority will be given to female microenterprise borrowers. The output will also support e-commerce platform development for microenterprises.

#### D. Summary Cost Estimates and Financing Plan

26. The project is estimated to cost \$62.5 million (Table 1). Detailed cost estimates by expenditure category and by financier are included in the project administration manual (PAM). The summary financing plan is in Table 2. ADB will finance the credit line. Additional financing could be considered upon timely liquidation of the full loan amount.

**Table 1: Summary Cost Estimates (\$ million)**

Items	Amount
Credit line	50.0
Microenterprise contribution <sup>a</sup>	12.5
<b>Total</b>	<b>62.5</b>

<sup>a</sup> Microenterprise borrowers must contribute at least 20% of total investments from their own sources.  
Source: Asian Development Bank.

<sup>18</sup> Because of the high operational cost in serving many small borrowers, microfinance interest rates are high. In South Asia, microfinance interest rates are 20%–30% per year. The global average microfinance interest rate is about 35% (C. Kneiding and R. Rosenberg. 2008. *Variations in Microcredit Interest Rates. CGAP Brief*. Washington, DC: Consultative Group to Assist the Poor).

<sup>19</sup> Under cluster development, microenterprises that produce similar products will be formed into groups and provided assistance in quality improvement, branding, and marketing for better quality and higher quantity production.

**Table 2: Summary Financing Plan**

<b>Source</b>	<b>Amount (\$ million)</b>	<b>Share of Total (%)</b>
Asian Development Bank		
Ordinary capital resources (regular loan)	50.0	80.0
Microenterprise contribution <sup>a</sup>	12.5	20.0
<b>Total</b>	<b>62.5</b>	<b>100.0</b>

<sup>a</sup> Microenterprise borrowers must contribute at least 20% of total investments from their own sources.  
Source: Asian Development Bank.

27. The government has requested a regular loan of \$50 million from ADB's ordinary capital resources to help finance the project. The loan will have a 20-year term, including a grace period of 5 years; an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; a commitment charge of 0.15% per year; and such other terms and conditions set forth in the draft loan and project agreements. Based on the straight-line method, the average maturity is 12.75 years, and there is no maturity premium payable to ADB.

28. ADB will disburse the loan proceeds following its *Loan Disbursement Handbook* (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB. The advance fund procedure will be used based on the estimate of the eligible expenditures for the forthcoming 6 months. To make sure that the ADB loan is used for its intended purpose, the PKSf will maintain all POs' sub-borrower records. In addition, the PKSf and all POs funded under the project will submit an audited statement of utilization of funds.

29. **Relending.** The government will relend the ADB loan proceeds to the PKSf in local currency at ADB's LIBOR-based interest rate plus 0.75% per year and a maturity of 20 years, including a grace period of 5 years, under a subsidiary loan agreement. The government will bear the foreign exchange risks.

30. **Onlending.** The PKSf will onlend to selective POs for financing eligible microenterprise borrowers. Onlending rates from the PKSf to POs are 7.5% per year for POs with total loans outstanding above Tk1.0 billion; 6.0% for POs with total loans outstanding of Tk0.5 billion–Tk1.0 billion; and 5.0% for POs with total loans outstanding below Tk0.5 billion. PKSf loans to POs will have a 3-year maturity, including a 6-month grace period.

31. **Sub-lending.** POs will finance their member microenterprise borrowers. Loans to microenterprise borrowers range from Tk50,000 to Tk1 million; the maturity will mostly be less than 1 year but can be up to 2 years. The repayment schedule will depend on the cash flow pattern of microenterprises. The maximum interest rate for the sub-loan is 25% per year based on a declining balance.<sup>20</sup> The loans repaid by POs will be maintained at the microenterprise fund account established at PKSf. PKSf will onlend to POs with the same onlending terms and conditions by PKSf.

## **E. Implementation Arrangements**

32. The Financial Institutions Division (FID) of the Ministry of Finance will be the executing agency and the PKSf will be the implementing agency. A project steering committee will be formed by the government comprising the Economic Relations Division and Finance Division of the Ministry of Finance, the FID, the PKSf, and other relevant stakeholders. The steering committee will monitor and supervise overall project implementation and provide guidance on

<sup>20</sup> A declining balance interest rate is calculated based on the outstanding principal loan amount.

major project implementation issues. The FID will provide guidance on day-to-day project implementation matters to the project implementation unit (PIU).

33. The PIU will be established at the PKSf. It will be led by a project coordinator and will have at least one full-time staff whose qualifications are satisfactory to ADB. The PIU will implement and monitor project implementation, coordinate with TA consultants, and report project progress to the Economic Relations Division, Finance Division, FID and ADB.

34. The implementation arrangements are summarized in Table 3 and described in detail in the PAM.<sup>21</sup>

**Table 3: Implementation Arrangements**

Aspects	Arrangements		
Implementation period	January 2019–December 2020		
Estimated completion date	December 2020		
Estimated loan closing date	March 2021 <sup>a</sup>		
Management			
(i) Oversight body	FID secretary in the Ministry of Finance (Chair) ERD representative in the Ministry of Finance (member) FD representative in the Ministry of Finance (member) FID representative (member) PKSF representative (member) Other relevant stakeholders (member)		
(ii) Executing agency	FID		
(iii) Implementing agency	PKSF		
(iv) Implementation unit	Project implementation unit, three staff under the supervision of the PKSf deputy managing director		
Consulting services	Individual consultant selection	9 person-months	\$484,000
	Firm: quality- and cost-based selection (90:10)	16 person-months	
Disbursement	ADB will disburse the loan proceeds following ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB. An advance account will be used.		

ADB = Asian Development Bank, ERD = Economic Relations Division, FD = Finance Division, FID = Financial Institutions Division, PKSf = Palli Karma Sahayak Foundation.

<sup>a</sup> The expected closing date is March 2021 for the loan and the technical assistance.

Source: Asian Development Bank.

### III. ATTACHED TECHNICAL ASSISTANCE

35. The transaction TA will assist the PKSf and its POs in enhancing their capacity in microenterprise lending and promoting their sustainable operations. Its outcome and outputs align with the loan. The TA will support (i) developing the PKSf's medium-term institutional strengthening and financing strategy and building capacity at the PKSf, (ii) improving microenterprise finance operational guidelines for MFIs and providing MFI training, (iii) initiating a pilot mobile-based microenterprise financing application for selected POs, (iv) supporting microenterprise cluster development, and (v) developing a microenterprise e-commerce platform.

36. The TA will require inputs from the following international experts: technical advisor for Microenterprise Development Project (3 person-months), microenterprise finance specialist (3 person-months), and e-commerce specialist (3 person-months); and from the following national experts: mobile microfinance specialist (6 person-months), microenterprise development

<sup>21</sup> Project Administration Manual (accessible from the list of linked documents in Appendix 2).

specialist (4 person-months), and financial analysis specialist (6 person-months). Procurement will follow the ADB Procurement Policy (2017, as amended from time to time) and its associated staff instructions. ADB will procure consulting services using open competitive bidding procedures.

37. The TA is estimated to cost \$550,000, of which \$500,000 will be financed on a grant basis by the Financial Sector Development Partnership Special Fund.<sup>22</sup> The PKSf will provide counterpart support in the form of counterpart staff, and other in-kind contributions. Disbursement will follow ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time). The TA will be implemented over 2 years.

#### IV. DUE DILIGENCE

##### A. Technical

38. ADB assessed the selected POs' technical capacity to make microenterprise loans. POs have dedicated staff and established procedures for loan appraisal, loan sanction, and portfolio monitoring and reporting for microenterprise loans. Further support to improve MFI capacity for microenterprise financing is needed, however, particularly for client due diligence, credit risk assessment, portfolio monitoring, and the management information system. For this, the project will support the PKSf and its POs through the attached TA.

##### B. Economic and Financial

39. The project will directly benefit at least 40,000 microenterprises in Bangladesh, of which 70% are female borrowers, by providing a reliable and affordable institutional source of finance. In doing so, the project greatly economizes the beneficiaries' fund costs and promotes the efficient allocation of finance, thus yielding a higher rate of return from the beneficiaries' microenterprise investments.<sup>23</sup>

##### C. Governance

40. ADB requirements and policies on financial management and procurement measures, and environmental and social safeguards, were discussed and agreed with the government and the PKSf and incorporated in the project design. The specific requirements are described in the PAM. Procurement of goods, works, and non-consultancy services will follow the ADB Procurement Policy and the Procurement Regulations for ADB Borrowers (2017, as amended from time to time). Procurement will be undertaken by the individual beneficiary; fitness for purpose can be achieved by using established private sector and commercial practices.

41. The financial management risk is *moderate*. Based on financial due diligence, the PKSf needs to strengthen its capacity particularly its management information system. The financial management assessment, which includes a financial analysis of POs, indicated that the PKSf has sufficient experience in managing similar projects for ADB and other international development partners and has the necessary financial management arrangements. The PKSf's POs, however, potentially have key financial management risks, such as (i) insufficient quality of

<sup>22</sup> Established by ADB. Financing partner: the Government of Luxembourg.

<sup>23</sup> The project beneficiaries' only alternative source of funding, apart from relatives and friends, is informal moneylenders who typically charge more than 120% per year. The project provides cost-efficient and reliable access to finance for the beneficiaries.

POs' audit and financial statements, and (ii) inadequate POs' portfolio management practices. The attached TA will address these issues.

42. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the PKSf. The specific policy requirements and supplementary measures are described in the PAM (footnote 21).

#### **D. Poverty, Social, and Gender**

43. The project is expected to have a tangible employment generation impact on the poor and low-income population by establishing and expanding microenterprises. The estimated monthly income of microenterprise workers in manufacturing, processing, or services ranges from Tk4,000 for part-time workers to Tk15,000 for full-time workers.<sup>24</sup> Considering Bangladesh's per capita gross national income in FY2017 was Tk127,401, the project is expected to contribute to poverty reduction by increasing rural household incomes.<sup>25</sup> The project has a strong focus on developing women-led microenterprises and will develop MFI capacity in conducting women-focused microenterprise financing. The project is classified *gender equity as a theme*.<sup>26</sup>

#### **E. Safeguards**

44. In compliance with ADB's Safeguard Policy Statement (2009), the project's safeguard categories are as follows:<sup>27</sup>

45. **Environment (category FI treated as C).** The project is expected to have minimal environmental impact since sub-loans to microenterprises will be mainly for light manufacturing, trade, and service activities.

46. **Involuntary resettlement (category FI treated as C).** Only sub-loans not requiring any involuntary resettlement will be financed.

47. **Tribes, minor races, ethnic sects and communities (category FI treated as C).** Sub-loans are for activities that will not have any impact on tribes, minor races, ethnic sects and communities.<sup>28</sup>

48. The PKSf has developed environmental and social screening guidelines for POs, which were agreed by ADB. Subproject screening will be mandatory for implementation by all POs to be financed under the project, and POs will report on the status of the screening checklist to ADB through the PKSf. The POs will

- (i) screen all subprojects to be financed under the project to ensure compliance with government regulations, project legal agreements, the PAM, and environmental and social screening guidelines; and

<sup>24</sup> International Fund for Agricultural Development. 2016. *People's Republic of Bangladesh: Finance for Enterprise Development and Employment Creation Project—Project Performance Assessment*. Rome; and ADB estimates.

<sup>25</sup> Government of Bangladesh, Bangladesh Bureau of Statistics. 2018. *National Accounts Statistics (Provisional Estimates of GDP, 2017–18 and Final Estimates of GDP, 2016–17)*. Dhaka.

<sup>26</sup> Gender Action Plan (accessible from the list of linked documents in Appendix 2).

<sup>27</sup> ADB. Safeguard Categories. <https://www.adb.org/site/safeguards/safeguard-categories>.

<sup>28</sup> Groups or population identified as indigenous peoples within the context of ADB's Safeguard Policy Statement will be referred to in this document as tribes, minor races, ethnic sects and communities (following the request of the Government of Bangladesh).

- (ii) exclude all subprojects with *category A* and *category B* impacts on the environment, involuntary resettlement, and tribes, minor races, ethnic sects and communities; and finance only subprojects that are classified *category C*.

## F. Summary of Risk Assessment and Risk Management Plan

49. Significant risks and mitigating measures are summarized in Table 4 and described in detail in the risk assessment and risk management plan.<sup>29</sup>

**Table 4: Summary of Risks and Mitigating Measures**

<b>Risk Description</b>	<b>Mitigation Measures</b>
Adverse political and security developments	Political and security risks have been muted since 2016. ADB has measures in place to manage and adjust activities during emergencies.
Corruption turning into loan fraud at POs	The PKSf conducts PO audits twice a year. In addition, the PKSf monitors POs' compliance with their financing agreements. POs must submit an audited statement of utilization of funds to ADB.
Restrictive government policy change on microfinance	Policy dialogues with the government and the MRA will be conducted throughout project implementation to facilitate the regulatory reform.
Cost of fund increase may raise the PKSf onlending rate to POs and lower demand for microenterprise loans	The project loan is expected to be disbursed within 12 months upon effectiveness and the risk of cost increase will be minimum. The attached TA will improve the PKSf's operations in view of the growing cost of funds.

ADB = Asian Development Bank, MRA = Microcredit Regulatory Authority, PKSf = Palli Karma Sahayak Foundation, PO = partner organization, TA = technical assistance.

Source: Asian Development Bank.

## V. ASSURANCES

50. The government and the PKSf have assured ADB that implementation of the project shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the PAM and loan documents.

51. The government and the PKSf have agreed with ADB on certain covenants for the project, which are set forth in the draft loan agreement and project agreement.

## VI. RECOMMENDATION

52. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$50,000,000 to the People's Republic of Bangladesh for the Microenterprise Development Project, from ADB's ordinary capital resources, in regular terms, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 20 years, including a grace period of 5 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan and project agreements presented to the Board.

Takehiko Nakao  
President

31 October 2018

<sup>29</sup> Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

## DESIGN AND MONITORING FRAMEWORK

<b>Impact the Project is Aligned with</b> Growth of microenterprises expanded to provide forward linkages to agriculture and generate job opportunities (National Sustainable Development Strategy, 2010–2021) <sup>a</sup>			
<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines<sup>b</sup></b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
<b>Outcome</b> Microenterprises' access to MFI financing increased	By December 2020 Microenterprise borrowers of the PKSf's POs increased by 40,000, of whom at least 70% are female (end-2017 baseline: 1.15 million, of whom 70% are women)	PKSf annual reports, executing and/or implementing agency's project completion report	Restrictive government policy change on microfinance may hinder the growth of microenterprise lending.
<b>Outputs</b> 1. Funding to MFIs for microenterprise loans expanded  2. MFIs' capacity in microenterprise lending enhanced	By December 2020 1a. Total microenterprise loans outstanding of the PKSf reached Tk17.00 billion (end-2017 baseline: Tk13.34 billion)  1b. Total microenterprise loan portfolio outstanding of the PKSf's POs reached Tk81 billion, of which at least 70% are for female borrowers (end-2017 baseline: Tk67 billion, of which Tk47 billion were to female borrowers)  1c. Medium-term institutional strengthening and financing strategy for the PKSf developed (2018 baseline: not applicable)  2a. Gender-inclusive microenterprise finance operational guidelines for MFIs improved (2018 baseline: not applicable)  2b. 80 POs trained on microenterprise lending operations (2018 baseline: not applicable)  2c. At least 10,000 microenterprise borrowers from at least 3 POs enrolled in a mobile-based microenterprise finance application and received training, of whom at least 70% are female (2018 baseline: not applicable)	1a–b. PKSf annual reports, implementing agency's project and TA progress reports  1c. PKSf medium-term institutional strengthening and financing strategy report  2a–c. PKSf annual reports, implementing agency's project and TA progress reports	Cost of fund increase may raise the PKSf onlending rate to POs and lower demand for microenterprise loans.

<b>Results Chain</b>	<b>Performance Indicators with Targets and Baselines<sup>b</sup></b>	<b>Data Sources and Reporting Mechanisms</b>	<b>Risks</b>
3. MFIs' microenterprise development support extended	<p>3a. MFIs' microenterprise cluster development support scheme implemented for at least 3 enterprise clusters covering at least 1,000 microenterprise borrowers, of whom at least 70% are female (2018 baseline: not applicable)</p> <p>3b. At least 3 microenterprise products branded by the PKSf uploaded to an e-commerce platform (2018 baseline: not applicable)</p>	3a–b. PKSf annual reports, executing and/or implementing agency's project and TA progress reports	
<p><b>Key Activities with Milestones:</b></p> <p><b>1. Funding to MFIs for microenterprise loans expanded (under the loan and attached TA)</b></p> <p>1.1 PKSf and government subsidiary loan agreement signing (Q4 2018)</p> <p>1.2 PKSf loan disbursement to PKSf POs (Q1 2019–Q4 2020)</p> <p>1.3 Microenterprise loan portfolio performance review (Q1 2019–Q4 2020)</p> <p>1.4 Consultant recruitment (Q1 2019)</p> <p>1.5 Consultations on medium-term institutional strengthening and financing strategy development for the PKSf (Q2 2019)</p> <p>1.6 Strategy dissemination workshop (Q3 2019)</p> <p><b>2. MFIs' capacity in microenterprise lending enhanced (under the attached TA)</b></p> <p>2.1 Consultant recruitment (Q1 2019)</p> <p>2.2 MFI consultations for microenterprise finance operational guidelines improvement (Q2–Q3 2019)</p> <p>2.3 MFI training on microenterprise lending (Q1–Q4 2020)</p> <p>2.4 POs' IT system review and online connectivity support plan development (Q2 2019)</p> <p>2.5 Online connectivity support plan implementation (Q3 2019–Q4 2020)</p> <p>2.6 POs' IT training (Q2 2019–Q4 2020)</p> <p>2.7 Pilot POs' selection and mobile application adaptation plan (Q2–Q3 2019)</p> <p>2.8 POs' system development and training (Q2–Q4 2019)</p> <p>2.9 Client information dissemination and training (Q2 2019–Q4 2020)</p> <p><b>3. MFIs' microenterprise development support extended (under the attached TA)</b></p> <p>3.1 Consultant recruitment (Q1 2019)</p> <p>3.2 Microenterprise cluster selection and enterprise support scheme plan development (Q2–Q3 2019)</p> <p>3.3 Implementation and monitoring of the support scheme (Q4 2019–Q4 2020)</p> <p>3.4 Microenterprise e-commerce platform development (Q1–Q2 2019)</p> <p>3.5 Microenterprise e-commerce platform rollout (Q2 2019–Q4 2020)</p>			
<p><b>Inputs</b></p> <p>Asian Development Bank: \$50 million (regular OCR loan)</p> <p>Financial Sector Development Partnership Special Fund: \$500,000 (TA grant)</p>			
<p><b>Assumption for Partner Financing</b></p> <p>Not applicable</p>			

IT = information technology, MFI = microfinance institution, OCR = ordinary capital resources, PKSf = Palli Karma Sahayak Foundation, PO = partner organization, Q = quarter, TA = technical assistance.

<sup>a</sup> Government of Bangladesh, Planning Commission. 2013. *National Sustainable Development Strategy (2010–2021)*. Dhaka.

<sup>b</sup> Performance targets show incremental achievements as the result of the project.

Source: Asian Development Bank.

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/RRPs/?id=51269-001-3>

1. Loan Agreement
2. Project Agreement
3. Sector Assessment (Summary): Finance (Inclusive Finance)
4. Project Administration Manual
5. Contribution to the ADB Results Framework
6. Development Coordination
7. Financial Analysis
8. Economic Analysis
9. Country Economic Indicators
10. Summary Poverty Reduction and Social Strategy
11. Risk Assessment and Risk Management Plan
12. Attached Technical Assistance Report
13. Gender Action Plan
14. Financial Intermediary: Environmental and Social Management System Arrangement

**Supplementary Document**

15. Financial Management Assessment