



Technical Assistance Report

Project Number:
Transaction Technical Assistance (TRTA)
November 2020

Kingdom of Bhutan: Capacity Building for Rural Finance Development

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Asian Development Bank

CURRENCY EQUIVALENTS
(as of 23 October 2020)

Currency unit	–	ngultrum (Nu)
Nu1.00	=	\$0.0135
\$1.00	=	Nu73.679

ABBREVIATIONS

ADB	–	Asian Development Bank
BDB	–	Bhutan Development Bank
CSI	–	cottage and small industry
FSDPSF	–	Financial Sector Development Partnership Special Fund
FY	–	fiscal year
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government of Bhutan and its agencies ends on 30 June. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2020 ends on 30 June 2020.
- (ii) In this report, “\$” refers to United States dollars.

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I. THE PROPOSED PROJECT

1. The Rural Finance Development Project will expand access to finance for rural cottage and small industries (CSIs). In addition, the project will improve the institutional capacity of Bhutan Development Bank (BDB) by supporting the implementation of a comprehensive institutional strengthening plan, including enhanced systems for CSI outreach. Finally, the project will enhance the capacity of rural CSIs to access financing by providing business development support and financial literacy training with gender inclusive outreach targets.

2. The proposed project's outcome is finance sector's rural financing capacity enhanced. The project is aligned with the following impact: productive and gainful rural employment opportunities generated.¹ The project has four outputs: (i) collateral-based rural CSI financing expanded, (ii) non-collateral-based rural CSI financing expanded, (iii) BDB's institutional capacity strengthened, and (iv) financial literacy training and business development support extended to rural CSIs. The project will be financed with a \$20 million loan from the concessional ordinary capital resources of the Asian Development Bank (ADB).

II. THE TECHNICAL ASSISTANCE

A. Justification

3. Although Bhutan's economy grew steadily during 2010–2018, averaging 6.02% annual GDP growth, the economy is still largely rural and agriculture-based, and there is significant economic disparity between urban and rural areas.² In rural areas, opportunities for both on-farm and off-farm employment are extremely limited and farmers mostly depend on subsistence production of crops and livestock.³ To generate productive rural employment opportunities, the Government of Bhutan recognizes CSIs as an economic driver that can positively impact employment, income generation, and poverty reduction, especially in rural areas. The government's Twelfth Five Year Plan, 2018–2023 emphasizes, among others, reducing poverty and inequality, creating productive and gainful employment, and promoting gender equality (footnote 1). The Twelfth Five Year Plan especially focuses on creating income-generating opportunities for vulnerable populations and enhancing the rural economy by promoting CSIs.

4. In Bhutan, CSIs constitute more than 90% of total enterprises and employ about 99,288 people, with 22,064 registered CSIs in 2019.⁴ However, despite the government support, CSIs have poor access to finance and face constraints related to labor regulations, taxation, and registration requirements. Access to finance is by far the largest constraint.⁵ CSIs generally lack the capacity to develop business proposals, which are needed to qualify for financing from formal financial institutions. Most CSIs lack the financial literacy to confidently apply for loans from formal

¹ Government of Bhutan, Gross National Happiness Commission. 2019. *Twelfth Five Year Plan, 2018–2023—Just, Harmonious and Sustainable Society through Enhanced Decentralisation*. Thimphu.

² ADB. 2019. *Key Indicators for Asia and Pacific 2019*. Manila. <https://data.adb.org/dataset/bhutan-key-indicators>

³ On-farm enterprises are mainly involved in commercial farming and livestock production. Off-farm enterprises are involved in all types of economic activities other than subsistence production and other on-farm activities.

⁴ Ministry of Economic Affairs. Government of Bhutan. 2019. *Cottage and Small Industry Policy 2019*. Thimphu.

⁵ In an enterprise survey conducted by the Ministry of Economic Affairs in 2011, more than 80% of CSIs identified access to finance as a major constraint. Royal Government of Bhutan. 2012. *Cottage, Small & Medium Industry Development Strategy (2012–2020) & Action Plan (2012–2014)*. Thimphu. A World Bank enterprise survey in Bhutan in 2015 found that 23.8% of small- and medium-sized enterprises identified access to finance as the largest obstacle, followed by labor regulation (22.6%) and high tax rates (12.1%). World Bank. 2015. *Enterprise Surveys: Bhutan*.

financial institutions.⁶ Men- and women-owned CSIs face similar challenges; however, these challenges are often greater for women, who suffer from low literacy and lack of confidence. Access to finance is particularly scarce for rural CSIs because of the limited presence of formal financial institutions in rural areas.⁷

5. BDB is the key rural finance institution in Bhutan. It provides most CSI loans, as other commercial banks tend to focus on urban and corporate clients, lack business expertise in serving CSIs and rural communities, and have stringent collateral requirements for CSIs.

6. BDB's key function is to provide financial services to agricultural, commercial, and industrial enterprises, especially CSIs. However, despite its mandate, BDB's outreach to rural CSIs has been moderate because of its weak operational and financial performance and insufficient financial literacy training, business development support and other forms of social mobilization to its clients.⁸ To expand rural CSI financing, BDB will need to, among others, (i) improve its overall financial and operational performance; (ii) direct its strategic focus and business orientation more toward rural and agriculture financing; (iii) make its policies, products, and business processes suitable for the rural, agriculture, and CSI market; and (iv) develop the capacity of its staff, especially credit officers on rural, agriculture, and CSI financing. In addition, BDB needs to enhance its nonfinancial services to reach rural CSIs.

7. The technical assistance (TA) will improve BDB's financial and operational performance and develop BDB's capacity to significantly expand rural CSI financing outreach. The TA outputs, which will support the achievement of the project's outputs, are (i) BDB's institutional capacity strengthened, and (ii) financial literacy training and business development support extended to rural CSIs. The TA is included in the Country Operations Business Plan for Bhutan, 2021–2023.⁹

B. Outputs and Activities

8. The TA's major outputs and activities are summarized in Table 1.

Table 1: Summary of Major Outputs and Activities

Major Outputs	Delivery Dates	Key Activities with Milestones
Output 1: BDB's institutional capacity strengthened		
1.1 BDB institutional strengthening milestones implemented	Q1 2021 – Q4 2024 Q2 2021, Q2 2022, Q2 2023, and Q2 2024	1.1 BDB institutional strengthening plan implementation 1.2 BDB institutional strengthening plan implementation monitoring and evaluation
Output 2: financial literacy training and business development support extended to rural CSIs		
2.1 Financial literacy of at least 4,000 CSIs, of which 50% are owned by women, improved ^a	Q3 2021 – Q4 2021 Q3 2021 – Q4 2021	2.1 Financial literacy training module developed 2.2 Financial literacy training operational plan developed

⁶ Financial literacy generally refers to the ability to understand and employ financial management skills including personal financial planning, budgeting, and investing.

⁷ In Bhutan, only 3% of the population borrowed money to start, operate, or expand a farm or rural business in 2014. World Bank. Global Financial Inclusion Database 2014. (accessed 2020). <https://microdata.worldbank.org/index.php/catalog/2395>

⁸ Social mobilization in access to finance refers to nonfinancial services to make clients bankable and can include literacy and financial literacy training.

⁹ ADB. 2020. *Country Operations Business Plan: Bhutan, 2021-2023*. Manila.

Major Outputs	Delivery Dates	Key Activities with Milestones
2.2 Business development services extended to at least 2,000 rural CSIs, of which 50% are owned by women ^b	Q1 2022 – Q4 2024	2.3 TOT on financial literacy to credit officers provided
	Q1 2022 – Q4 2024	2.4 Financial literacy training operational plan implementation and monitoring
	Q3 2021 – Q4 2021	2.5 Business development service process and methodology developed
	Q1 2022 – Q4 2024	2.6 Training on business development service to credit officers provided
	Q1 2022 – Q4 2024	2.7 Business development service operation monitoring and evaluation

BDB = Bhutan Development Bank, CSI = cottage and small industry, Q = quarter, TOT = training of trainers.

^a Financial literacy generally refers to the ability to understand and employ financial management skills including personal financial planning, budgeting, and investing.

^b Business development services refer to simple template-based business plan development assistance, basic bookkeeping training, and other support.

Source: Asian Development Bank estimates.

C. Cost and Financing

9. The TA is estimated to cost \$1,000,000, of which (i) \$750,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF 6); and (ii) \$250,000 will be financed on a grant basis by the Financial Sector Development Partnership Special Fund (FSDPSF).¹⁰ BDB will provide counterpart contribution equivalent to \$50,000 in the form of office space, counterpart staff, logistical support, and other in-kind contributions. Disbursement will follow ADB's *Technical Assistance Disbursement Handbook* (2020, as amended from time to time). The TA will be implemented over 4 years. The key expenditure items are listed in Appendix 1. Under the FSDPSF, eligible expenditures include (i) consulting services, (ii) capacity building, (iii) advisory services, (iv) pilot of new financing instruments, (v) small equipment and systems procurement, and (vi) support to regional financial cooperation among developing member countries. The following are non-eligible expenditures for FSDPSF: (i) vehicle purchases, and (ii) salaries for civil servants.

D. Implementation Arrangements

10. **Consulting services.** ADB will administer the TA. ADB's South Asia Department will select, supervise, and evaluate the consultants. ADB will recruit international and national consultants using individual consultant selection. ADB will procure consulting services following the ADB Procurement Policy (2017, as amended from time to time) and the staff instructions for ADB-administrated consultants. The required consultant inputs include (i) international technical advisor to BDB (6 person-months), (ii) international bank restructuring specialist (16 person-months), (iii) international bank capacity development specialist (16 person-months), (iv) international rural finance specialist (16 person-months), (v) national core banking system specialist (9 person-months), (vi) national environmental and social safeguards specialist (3 person-months), and (vii) national gender specialist (5 person-months).¹¹

11. **Procurement of goods and non-consultancy services.** Procurement of goods and non-consultancy services, if any, will be procured following procedures explained in the staff

¹⁰ Established by ADB. Financing partner: the Government of Luxembourg.

¹¹ Terms of Reference for Consultants (accessible from the list of linked documents in Appendix 2).

instructions for TA procurement of goods, works, and non-consultancy services. The implementation arrangements are summarized in Table 2.

Table 2: Implementation Arrangements

Aspects	Arrangements		
Indicative implementation period	January 2021–December 2024		
Executing agency	MOF (DMEA)		
Implementing agency	BDB		
Consultants	To be selected and engaged by ADB		
	Individual consultant selection	International consultancy services for (i) technical advisor to BDB (6 person-months), (ii) bank restructuring specialist (16 person-months), (iii) bank capacity development specialist (16 person-months), and (iv) rural finance specialist (16 person-months). National consultancy services for (i) core banking system specialist (9 person-months), (ii) environmental and social safeguards specialist (3 person-months), and (iii) gender specialist (5 person-months).	\$630,520
Disbursement	The TA resources will be disbursed following ADB's <i>Technical Assistance Disbursement Handbook</i> (2020, as amended from time to time) The disbursement from each TA fund source will be based on the cost sharing as described in the cost estimates and financing plan (Appendix 1).		

ADB = Asian Development Bank, BDB = Bhutan Development Bank, DMEA = Department of Macroeconomic Affairs, MOF = Ministry of Finance, TA = technical assistance.

Source: ADB.

COST ESTIMATES AND FINANCING PLAN
(\$)

Item	Amount
A. Asian Development Bank^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	498,224
ii. National consultants	74,520
b. Out-of-pocket expenditures	
i. International and local travel	37,000
2. Training, seminars, and conferences	60,000
3. Contingencies	80,256
Subtotal (A)	750,000
B. Financial Sector Development Partnership Special Fund^b	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	145,472
ii. National consultants	17,420
b. Out-of-pocket expenditures	
i. International and local travel	11,100
2. Training, seminars, and conferences	40,000
3. Contingencies	36,008
Subtotal (B)	250,000
Total	1,000,000

Note: The technical assistance (TA) is estimated to cost \$1,000,000, of which contributions from the Asian Development Bank and the Financial Sector Development Partnership Special Fund are presented in the table above. Bhutan Development Bank (BDB) will provide counterpart contribution in the form of office space, counterpart staff, logistical support, and other in-kind contributions. The value of BDB's contribution is estimated to account for 6.7% of the total TA cost.

^a Financed by the Asian Development Bank's Technical Assistance Special Fund (TASF 6).

^b Financing partner: the Government of Luxembourg.

Source: Asian Development Bank estimates.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/LinkedDocs/?id=53307-001-TARreport>

1. Terms of Reference for Consultants