Report and Recommendation of the President to the Board of Directors

Project Number: 46923
October 2013

Proposed Guarantee Facility
Rural Financial Inclusion and Dairy Growth Facility (Pakistan)

This is an abbreviated version of the document approved by ADB's Board of Directors that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communication Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 19 September 2013)

Currency unit	–	Pakistan rupee/s (PRe/PRs)
PRe1.00	=	$0.00946
$1.00	=	PRs105.7

ABBREVIATIONS

ADB	–	Asian Development Bank
DFID	–	Department for International Development
CEO	–	chief executive officer
EFL	–	Engro Foods Limited
ESMS	–	environmental and social management system
GDP	–	gross domestic product
HBL	–	Habib Bank Limited
PCG	–	partial credit guarantee
PCB	–	participating commercial bank
PDC	–	participating dairy company
SBP	–	State Bank of Pakistan

NOTES

(i) The fiscal year (FY) of Habib Bank Limited and Engro Foods Limited ends on 31 December. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2013 ends on 31 December 2013.

(ii) In this report, “$” refers to US dollars.

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CONTENTS

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed guarantee facility of up to $35,000,000 (or Pakistan rupee equivalent) for eligible financial institutions for the Rural Financial Inclusion and Dairy Growth Facility in Pakistan.[1]

II. THE FINANCIAL INTERMEDIARY

A. Investment Identification and Description

2. After nearly a decade of strong growth, Pakistan's economy has slowed significantly since 2008. The private investment climate is challenging, characterized by rapid inflation, weak fiscal discipline and public sector governance, and an unresolved energy crisis. Despite a modern regulatory banking system, Pakistan's financial intermediation trails its regional peers. Commercial bank credit was only 20% of gross domestic product (GDP) in 2012, down from 29% in 2008. High fiscal deficits undermine private access to funding at affordable costs. Financial inclusion remains low: only 3% of the adult population has loan accounts and 28% has deposit accounts.[2] Poverty remains widespread. The World Bank estimated that 60% of the population earned less than $2 per day in 2008. The government's poverty head count ratio is 27% in rural areas and 13% in urban areas.[3]

3. In this challenging investment climate, Pakistan's large private banks have shown resilience. Their asset quality, profitability, and solvency have remained substantially better than their smaller and public sector peers. The banking system continues to have ample liquidity representing 49% of total bank assets.[4] In addition, strong domestic demand and continued access to funding have helped large listed companies remain resilient.

4. Pakistan's rural economy contributes substantially to employment (45%)[5] and GDP (20%).[6] However, only 5% of bank loans are to the agriculture sector, and half of those are provided by public sector banks at subsidized rates (footnote 3). Access to public sector bank loans is limited and often based on relationships rather than farmers' creditworthiness. Among the constraints on lending to farmers are the banks' difficulty in monitoring remote farms, high farm risks and farmers' inability to provide requisite documentation. The State Bank of Pakistan (SBP) and commercial banks recognize that more inclusive ways are needed to link farmers to markets, increase their productivity, and transform them into creditworthy partners.

5. Pakistan is one of the five largest milk producers in the world, generating 38 billion liters annually.[7] It has more than 8 million dairy-producing households, representing 35 million people. Dairy production is estimated to currently grow at 2%–4% annually, and accounted for 12% of GDP and 55% of agricultural GDP in 2012. Only 54% of produced milk is tradable, 93% of which is provided to the consumers as loose milk. While packaged dairy products still constitute a small market segment at 1.4 billion liters annually (or 7% of tradable milk), the demand is growing 10%–15% per year—outpacing annual production growth. This indicates a growing supply shortage and the need to source more milk from small farmers. The binding constraints

[1] The design and monitoring framework is in Appendix 1.
[2] International Monetary Fund. Access to Finance Database, http://www.imf.org/ (accessed 27 August 2013).
[3] World Bank. Pakistan Metadata. http://data.worldbank.org/country/pakistan (accessed 2 September 2013).
[4] State Bank of Pakistan. 2013. *Quarterly Compendium on Financial Soundness Indicators*. Karachi.
[5] Refers to 2008. World Bank, 2013. *Pakistan Country Economic Memorandum*. Washington, DC.
[6] Refers to 2012. World Bank. Pakistan Metadata. http://www.worldbank.org/ (accessed on 2 September 2013).
[7] Information provided by Engro Foods Limited. The estimates should be interpreted with caution since unrecorded volumes are high, and a large part of the milk being consumed by farmers and wastage is known to be substantial.

facing the dairy sector are discussed in paras. 6–9.

6. **Small farm size.** Farms with less than 10 cattle provide 80% of the milk supply, representing 92% of the dairy stock. However, the low yielding dairy stock and the small farm size limits the production of animal feed and the farms' overall dairy yield. Average yields at less than 4 liters per cattle per day are low compared with local commercial farms, which normally exceed 15 liters per cattle. In addition, losses from inadequate cooling facilities exceed 25% of production. There are only a few medium-sized and large farms with more than 100 cattle. These require long periods to reach profitability and represent less than 10% of the market production.

7. **Low quality and capital availability.** Intermediaries dominate the supply chain and often contaminate milk through mishandling. Milk is largely sold unpackaged, compromising consumer health. Most farmers lack even minimal management skills and investment capital.

8. **Investment identification.** Since September 2011, ADB has explored opportunities to promote rural financial inclusion in Pakistan through an inclusive business approach by linking farmers to agribusiness companies and banks to achieve high business and social impact. Consultations with the government, development partners, private commercial banks, and agribusiness companies identified the dairy value chain as a promising entry point. Providing private investment capital to promote the use of locally adapted, higher-yielding dairy cattle would enhance private, government, and development partner efforts to improve rural incomes, and farm management.

9. The consultation process resulted in an inclusive business design of the facility that aims to provide dairy farmers access to investment capital to increase farm yields and dairy outputs, reduce losses, and improve the quality of milk. The proposed approach entails collaboration and risk sharing between participating dairy companies (PDCs) that source milk from farmers and participating commercial banks (PCBs) that provide loans to farmers in Pakistan. Because of the untested nature of the approach and farm risk, the Department for International Development of the United Kingdom (DFID) and SBP have agreed to provide a 20% first-loss guarantee from their existing Financial Inclusion Program.[8] In exchange for being able to select farmers and benefit from increasing milk sales, PDCs will have to participate significantly in the credit risk to ensure good management and assistance of their veterinary services to farmers. To ensure scalability, ADB has discussed the inclusive business approach with a number of banks, including Habib Bank Limited (HBL), and dairy market leaders, including Engro Foods Limited (EFL). After 2 years ADB reached an agreement with HBL, EFL, SBP, and DFID on the terms of the untested inclusive business approach.

B. Business Overview and Strategy

10. To reduce production losses and meet the increasing domestic demand, dairy producers will move their direct milk sourcing network closer to the farmers and increase their farm veterinary services to help improve farm management. HBL has been identified as the first PCB and EFL as the first PDC that meet the eligibility criteria under the facility. Subject to Board approval, ADB will identify other PCBs and PDCs in a manner set forth in para 26.

11. Established in 1941, HBL is Pakistan's largest bank with assets of PRs1,518 billion ($14.4 billion) and market shares of 11% of loans and 15% of deposits at the end of FY2012. It

[8] SBP will be the guarantor of record, with funding provided by DFID. The program includes a nationwide guarantee facility to support access of small and medium-sized enterprises and farmers to bank finance. http://projects.dfid.gov.uk/project.aspx?Project=113331

has 1,497 branches, representing about 15% of Pakistan's bank branch network. With PRs18 billion ($170 million) HBL is the largest private lender to agriculture. The facility will provide finance to farmers who would not normally qualify as borrowers under HBL's existing lending criteria. Linking HBL's widespread branch network and credit underwriting experience in rural areas with the strengths of EFL provides an untapped opportunity for inclusive business.

12. EFL's assets have grown quickly, reaching PRs22.2 billion ($209 million) at the end of FY2012. EFL improved its long-term debt-to-equity ratio from 47.5% at the end of FY2010 to 37.5% at the end of FY2012. EFL's liquidity remained healthy as the current ratio improved from 1.5 at the end of FY2010 to 2.1 at the end of FY2012. Net after tax income increased more than fourteen-fold since 2010 to PRs2.6 billion ($25 million), driven by strong revenue growth, which reached PRs40 billion ($378 million) in FY2012. Profitability improved consistently in FY2012, with return on equity reaching 25.8%, compared with 3.4% in 2010. In 2012, EFL received the Group of Twenty international inclusive business award for successful integration of small farmers in its business model.

C. Ownership, Management, and Governance

1. Habib Bank Limited

13. **Ownership.** Privatized in 2004, HBL is owned by the Aga Khan Fund for Economic Development (51%); SBP, representing the government (41.5%); and the public (7.5%) through its listing on Pakistan's stock exchanges.

14. **Management.** Nauman K. Dar, the chief executive officer (CEO) is supported by senior managers in retail, corporate, and Islamic banking, as well as treasury, financial control, risk management, strategic planning, human resources, legal, operations, and information technology. Management is supported by senior staff through dedicated departments for asset–liability management, risk management, credit policy, and operational risk management. HBL has an independent risk management department covering credit, portfolio, market, and liquidity risks. It reports to the board's risk management committee.

15. **Governance structure.** HBL is a Public listed company with a strong governance structure with an 8 member Board representing the shareholders and with independent Directors as required by Law. The board has 3 sub committees, Audit, Human Resource & Remuneration and the Risk Management Committee, each of which is chaired by a non executive Director.

16. HBL has an independent audit department whose chief reports to the board's audit committee. HBL has adequate anti-money-laundering systems in compliance with local regulations. Transactions are monitored using specialized software. An anti-money-laundering officer reports to the chief compliance officer. The compliance unit reports transactions to SBP.

2. Engro Foods Limited

17. **Ownership.** Established in 2006, EFL is a 90% owned subsidiary of Engro Holdings Corporation Limited. It is a diversified conglomerate with operations in food and beverage, fertilizer, energy, trading, chemicals, storage, and engineering. Fourty-eight percent of its shares are held by prominent institutional and high net worth investors with the remaining shares being traded on Pakistan's stock exchanges. Like its parent, EFL is subject to the exchange's disclosure and corporate governance regulations under the supervision of the Securities and Exchange Commission.

18. **Management.** CEO Sarfaraz Rehman led EFL from its foundation in 2006 until September 2011 and again since July 2013. He is an experienced industry manager in Pakistan and was vital in building EFL. He is assisted by a 10-member management committee of experienced managers who lead business units for sales, marketing, and dairy supply chain, as well as support units including finance, human resources and administration, legal, and audit.

19. **Governance structure.** EFL has a 10-member board, including the CEO representing experienced professionals from finance, marketing, and operations. As a listed company, EFL also has an independent non- executive director who chairs the board's audit and finance committees.

D. Financial Performance

20. **Capital adequacy.** With a total capital adequacy ratio of 15.1% and a tier 1 capital ratio of 12.9%, HBL's capital adequacy exceeded SBP's regulatory minimum of 10% in FY2012. HBL is moving towards an internal ratings-based approach for credit and market risks, and is adopting an advanced measure for the operational risk capital charge. These reforms toward an integration of capital and risk management and strategic planning will improve automation and streamline business processes, and modify HBL's capital charge in FY2014.

21. **Asset quality.** HBL's asset quality is satisfactory and has substantially improved since 2009. It is above the sector average of 14.5% in Pakistan, where loans are rarely written off and nonperforming loan statistics carry substantial fully provisioned loss loans. While the overall nonperforming loan ratio (including losses) was reported at 10.1% in FY2012 , the net of loss nonperforming loan ratio was reported at 2.6% in FY 2012, reflecting HBL's prudent underwriting. HBL increased its exposure to the government and its entities through loans and treasury bills to 74% of its exposures at the end of FY2012 compared with 55% at the end of FY2009.

22. **Earnings.** For FY2012, net income reached PRs21.6 billion with a slight drop in the return on equity to19.3% and return on assets to 1.7% as result of asset growth of 42.7% during FY2012. Net income grew at a compound annual growth rate of 20.6% from 2009 to 2012, primarily because of robust asset growth at a compound annual growth rate of 22.7%. During FY2012, HBL's net interest margin dropped by about 150 basis points to 5.1% because of SBP interest rate reductions and higher deposit funding costs. HBL's profitability is strong compared with local peers and stable with 83% of its business funded by low-cost deposits and an 18.1% share of non-interest income to operating income.

23. **Liquidity and sensitivity to market risk.** In FY2012, HBL's deposit growth was 30% outpacing the industry average of 11%. More than half of the deposits are raised at low-cost from individuals, who tend to be less price-sensitive. Long-term assets are well covered as indicated by a net stable funding ratio consistently exceeding 115% since FY2009 and reaching 140% in FY2012. HBL's liquidity coverage ratio has consistently exceeded 150% since 2010.

E. Unique Features

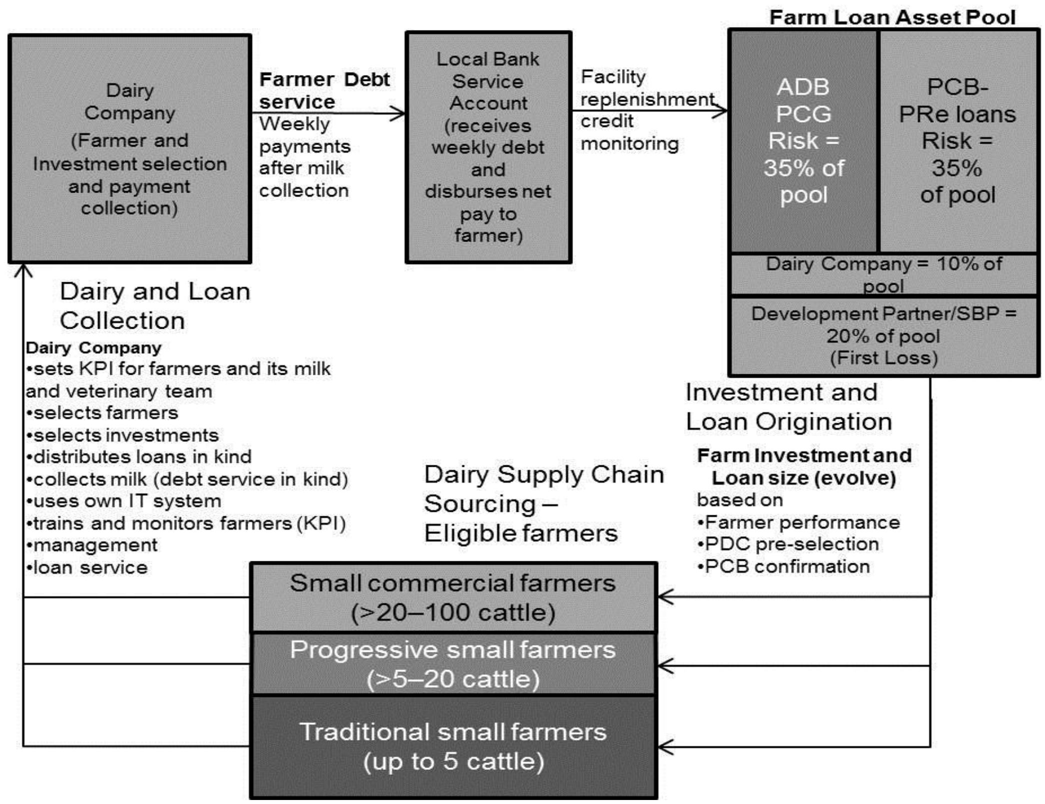
24. The facility involves an inclusive business approach in blending funding, skills, and outreach of PCBs, PDCs, and development partners to offer unbanked dairy farmers access to affordable credit. PDCs' ability to select suitable farmers and investments, and monitor farm management jointly with PCBs' underwriting and risk management skills, is far superior to traditional PCB lending. In addition, the first-loss risk cover (an essential feature of the facility) will alleviate high first-mover risks when developing this market segment. Also, the PDCs' risk

participation is essential to ensure its careful selection monitoring of, and advisory to farmers and their investments, and thereby identify and address risks early on. In this scalable model, ADB and the PCB can leverage an inclusive business model at limited risk.

III. THE PROPOSED ADB ASSISTANCE

A. The Assistance

Transaction Structure



ADB = Asian Development Bank, KPI = key performance indicator, IT = information technology, PCB = participating commercial bank, PCG = partial credit guarantee, PDC = participating dairy company, PRe = Pakistan rupee, SBP = State Bank of Pakistan.
Source: ADB.

25. The structure of the ADB assistance is illustrated in the figure. It entails a PCG facility of up to $35 million (or Pakistan rupee equivalent) in support of investment loans made to dairy farmers in Pakistan. Under the facility, PCGs in favor PCBs may be entered into by ADB up to 4 years after Board approval. Such PCGs will cover loans made by PCBs with a tenor of up to 5 years that can be disbursed within 5 years from the signing of such PCG. The size of the facility is adequate, taking into account the rapidly increasing market demand and the positive responses from possible PCBs and PDCs. DFID expressed interest to guarantee the first loss under the facility.

B. Implementation Arrangements

26. Under the facility, ADB will select PCBs and PDCs that will benefit from ADB's PCGs, subject to the eligibility criteria set out in the implementation arrangements, and standard due diligence procedures of ADB's private sector operations. Subject to approval by the Board of the

facility, ADB's Investment Committee will be authorized to review and approve each PCB, PDC, and the amount and structure of each PCG under the facility. To reduce ADB's credit risk, other parties will take junior positions under guarantee structures, before ADB's PCG will be triggered.[9] ADB will only incur losses under its PCGs after the other guarantors have assumed their losses. For each PCG, ADB will require a PDC to assume either a first-loss or second-loss position but in any event a position under which it bears the risk of loss either in priority to, or ranking equally with ADB. ADB will also require the PCB to retain a significant portion of the overall risk of loss under each guarantee structure.

27. A first PCG under the facility has been targeted and is currently under negotiation. The principal amount guaranteed under this PCG will be up to $3 million (or Pakistan rupee equivalent) and cover 35% of the outstanding principal in a portfolio of loans to be made by HBL to eligible dairy farmers selected by EFL and HBL. The loans will fund the purchase of cows and associated capital expenses such as sheds and animal feed. EFL will select farmers and assist them in selecting healthy dairy cows. EFL will purchase the produced milk and the proceeds will be used to service the farmers' loans directly from the milk sales. SBP as a guarantor of record for DFID will issue a first-loss guarantee of 20% of the loan pool. EFL will issue a second-loss guarantee of 10% of the loan pool. ADB will guarantee 50% of the losses that exceed the first and second loss threshold. The remaining risk will be retained by HBL.

28. The individual PCGs and their structures (including first loss requirements, tenors, fee rates, and security arrangements) under the facility, including the first PCG referred to above, will be tailored to the circumstances and needs of each PCB and PDC, and will take into account the experience with earlier similar transactions.

29. HBL, EFL, and other participating banks and companies will be required to provide annual audited financial statements in accordance with applicable financial reporting standards.[10] They will also provide quarterly progress reports and financial statements of the guaranteed loan pools. Reporting requirements include (i) status updates on governance, safeguards, and annual reports of the PCB's facility environmental and social management system (ESMS); (ii) updates on the PCBs' business and loan pool performance, and utilization of the ADB PCG limit; and (iii) development effectiveness. ADB will field review missions at least annually and discuss progress with the PCBs, PDCs, SBP, and DFID or other guarantors.

C. Value Added by ADB Assistance

30. **Strengthening agriculture through an innovative, inclusive business model.** ADB plays a vital role in providing a viable and scalable inclusive business model to farmers that benefits from the collaboration and risk sharing of PDCs and PCBs. The business model's key features include (i) PDCs' market knowledge and ability to source quality milk from small farmers; (ii) PDCs' ability to identify farmers and investments to increase farm yields and income; (iii) PDCs' veterinary services to advise farmers in animal and farm management; (iv) commercial risk capital leveraged through risk shared by development partners, PDCs, and PCGs; (v) investment and credit cash flows controlled from abuse by limiting direct cash payments to farmers; (vi) alignment of PCB, PDC, and farmer interests in boosting sales, income, and creditworthiness; (vii) improvement of financial and farm management literacy through monitoring and field advice; and (viii) improvement in the understanding of farmer risk profiles through a staged learning-by-doing process.

[9] A first-loss guarantee may be issued by a third party in combination with a second-loss guarantee issued by another party. This may include SBP as a guarantor of record for DFID or DFID directly.
[10] Commercial banks and listed companies in Pakistan are required to publish annual audited accounts in accordance with international financial reporting standards.

31. **Catalyzing sustainable private funding at affordable rates.** The risk participation will offer PDCs incentives to select farmers carefully. Banks currently do not lend to small farmers, while microfinance and money lenders charge annual effective interest rates of more than 30%. The risk participation will enable financial institutions to provide affordable borrowing and/or lending rates to the farmers. The need for first-loss cover funded by development partners is expected to diminish gradually once the track record for this product is established and widely accepted by PCBs and PDCs.

32. **Enhancing corporate governance and risk management.** Through on-site monitoring and dialogue, ADB will support the adherence of PCBs and PDCs to high corporate governance and social, environmental, and fiduciary standards. It will also enhance risk management.

D. Risks CONFIDENTIAL INFORMATION DELETED

IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

A. Development Impact, Outcome, and Outputs

33. **Impact.** The facility will contribute to (i) the growth of small, high-value-added dairy products in Pakistan; (ii) the scaling up of commercial banking services for small dairy farmers; and (iii) improvements in dairy farmers' access to investment capital.

34. **Outcome.** The facility will provide a scalable commercial model for providing credit to small farmers. Once successfully tested, this model will provide for sustainable credit outreach to small farmers, substantial revenue through higher-yielding cows, and increased farmer productivity.

35. **Outputs.** The outputs include (i) increased access of small dairy farmers to finance, (ii) the establishment of a sustainable farmer credit program, and (iii) improved farm management.

B. Alignment with ADB Strategy and Operations

1. Consistency with Strategy 2020 and Country Strategy

36. Under Strategy 2020, ADB aims to strengthen its support for the finance sector by assisting in the development of financial infrastructure, institutions, and products and services, as well as by promoting inclusive growth.[11] Through such initiatives, ADB will encourage the channeling of savings into productive investments. The building of inclusive financial systems will be supported by the facility funding agriculture where productivity is low and the potential for employment and income generation is high. The facility will help establish an inclusive business model for commercial banks to reach dairy farmers who do not have access to affordable commercial funding, consistent with efforts by the government, SBP, DFID to promote agricultural growth. Strategy 2020's target for poverty reduction through private sector development will be directly addressed by linking small farmers and their families to markets, and providing them access to credit and productive assets. Consistent with Strategy 2020, the facility will demonstrate an inclusive business approach and leverage a partnership with the existing Financial Inclusion Program of SBP and DFID.

37. The facility supports the development objectives of the government, which include finance for development. The country partnership strategy for Pakistan, 2009–2013 emphasizes

[11] ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020.* Manila.

the need for reforms, including measures to improve productivity in agriculture and promote the private sector. [12] ADB's consultations with stakeholders highlight the importance of the private and financial sector, as well as the need to improve financial inclusion, especially in rural areas. More commercial financial services will capture essential qualitative inclusive business growth opportunities and encourage sound risk management. Capital support through the partnership of banks and agribusiness present a strong inclusive business transaction through ADB's private sector operations.

2. Consistency with Sector Strategy and Relevant ADB Operations

38. The facility is consistent with ADB's financial sector operational plan and the 2007 report of the working group on rural poverty, which emphasizes the importance of rural finance and promotes financial inclusion of underserved poor households and farmers.[13]

V. POLICY COMPLIANCE

A. Safeguards and Social Dimensions

39. The facility is classified as category FI under ADB's Safeguard Policy Statement (2009). On social safeguards, the facility is category FI treated as C for impacts on involuntary resettlement and indigenous peoples. Sub-loans classified as environment category A and social safeguard categories A and B will not be financed under the facility.

40. The sub-loans to be guaranteed by the first PCG will finance the acquisition of cows and associated capital expenses targeting small farmers in Punjab province. The sites are irrigated agricultural land far from notified protected ecosystems. The implementation of the PCG is expected to have minimal to moderate environmental impacts. Potential impacts on land, soil, water, air quality, and biodiversity are derived from (i) solid wastes from waste feed, animal waste, carcasses, and other hazardous wastes; (ii) wastewater from runoff from feed storage; (iii) ammonia and odors from manure, and dust from overgrazed pastureland; (iv) environmental damage of soil and water resources because of cattle access; and (v) spread of animal diseases.

41. For the first PCG, HBL and EFL have management systems in place and are committed to meeting ADB's safeguard requirements. The ESMS established by HBL in collaboration with EFL, with the agreed-upon modifications requested by ADB, is considered adequate to comply with ADB's Safeguard Policy Statement. EFL and HBL will ensure that investments using the PCG do not involve business activities on ADB's prohibited investment activities list. Under the first PCG, HBL will provide only sub-loans to be guaranteed by ADB classified as environment C until HBL's existing ESMS is enhanced to ADB's satisfaction. That will be triggered by the completion of measures addressing environmental impacts of sub-loans classified as category B. The ESMS provides for HBL compliance with applicable national safeguard requirements on environment, health, and safety; and safeguard requirements including labor laws in accordance with ADB's Social Protection Strategy.[14]

42. ADB has made significant efforts during its due diligence to assess HBL's and EFL's commitment and capacity for promoting gender equity, and to ensure that gender inclusiveness is an integral feature of this transaction. EFL targets females as an important beneficiary group in its dairy advisory services. EFL is engaging female trainers to target female members of farm

[12] ADB. 2009. *Country Partnership Strategy: Pakistan, 2009–2013*. Manila.
[13] ADB. 2007. *Rural Poverty Reduction and Inclusive Growth: Report of the Working Group on Rural Poverty.* Manila.
[14] ADB. 2001. *Social Protection.* Manila.

families in farm management. Since 2006, EFL has gained substantial experience in reaching out to farm women through a livestock worker program and recently through a train-the-trainer program to qualify women as cattle inseminators. The first PCG will directly benefit female household members of 280 families. EFL has established a team to advise and monitor the benefits these families over a 3-year period and has taken proactive steps to promote a gender-inclusive ethos, which is likely to generate significant benefits for female household members. This transaction is classified *some gender elements* under ADB's guidelines.[15]

B. Anticorruption Policy

43. HBL has Anti Fraud Policy and Code of Ethics in place and has been advised, and all future PCBs will be advised, of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, and remedies for ADB in the event of noncompliance.

C. Investment Limitations

44. The facility is within the medium-term, country, industry, group, and single investment exposure limits for nonsovereign investments.

D. Assurances

45. Consistent with the Agreement Establishing the Asian Development Bank[16] the Government of Pakistan will be requested to confirm that it has no objection to the proposed assistance to the facility. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the Board.

VI. RECOMMENDATION

46. I am satisfied that the proposed guarantee facility would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the issuance of partial credit guarantees under the guarantee facility of up to $35,000,000 (or Pakistan rupee equivalent) for eligible financial institutions for the Rural Financial Inclusion and Dairy Growth Facility in Pakistan, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Takehiko Nakao
President

7 October 2013

[15] ADB. 2012. *Guidelines for Gender Mainstreaming Categories of ADB Projects*. Manila.
[16] ADB. 1966. *Agreement Establishing the Asian Development Bank.* Manila.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and/or Indicators with Baselines	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
Impact (2024) Growth of high-value-added dairy products Commercial banking services for small dairy farmers scaled up Small dairy farmers' access to investment capital improved	Packaged dairy products sales reach 1.6 billion liters annually by 2024 (2012 baseline: 0.8 billion liters) At least 3 commercial banks offer dairy farmer credit by 2024 At least 2 PDCs work with banks to enhance lending for small farmers' investment by 2024	Government reports Dairy company reports SBP reports	**Assumptions** Farmers utilize credit offered Successful demonstration effect of ADB PCGs Demand for high-value dairy grows **Risk** Political risks
Outcome (2021) A scalable commercial model for small farmer credit and productivity enhancement provided	Outstanding dairy farm credit will exceed PRs1 billion (2019) Average daily yield increases to 10 liters per cow by 2021 (2012 baseline: 4 liters per cow) Average daily dairy revenue per farmer increases (owning up to 5 animals) to at least $7.5 in 2021 (2012 baseline: $1.2)	PDC and PCB reports Development effectiveness monitoring reports	**Assumptions** Farmers value benefits of dairy investments Veterinary services provided by PDCs **Risk** Moral hazard of PDCs and PCBs
Outputs (2019) Increased access of participating small dairy farmers to finance Sustainable dairy farmer credit program established Dairy farm management practices improved	Number of PDC -registered active client farmers increases to about 15,000 by 2019 (2012 baseline: 12,000) Farm dairy credit portfolio at risk >90days does not exceed 20% by 2019[a] Aggregate farm dairy loan losses <10% of total loans issued by 2019[a] Up to 3,000 families trained in dairy farm management[b] by 2019 Up to 3,000 female family members trained in dairy farm management by 2019[b]	PDC statistics and reports PCB reports Development effectiveness monitoring reports	**Assumption** Dairy companies invest according to their plans **Risks** Operational risk Farm credit risk Management risk

Activities with Milestones	Inputs
1. Board approval by October 2013 2. Financial close of the first transaction in November 2013 3. Target farmers selected by November 2013 4. Target farmers obtain credit November 2013–2018 5. Training activities for improved farm management undertaken in 2013–2015	Up to PRe equivalent of $35 million partial credit guarantees from ADB Up to PRe equivalent of $100 million dairy farmer loans provided by local banks Up to 30% subordinated guarantees provided by donors and dairy companies

ADB = Asian Development Bank, PCB = participating commercial bank, PCG = partial credit guarantee, PDC = participating dairy company, SBP = State Bank of Pakistan.

[a] As this is a new product there is no baseline.

[b] Output targets are based on the full utilization of $100 million equivalent in farmer credit. The farmer credit will be staggered with the first PCG involving 280 farm families including 280 female farm household members as well as $7.2 million equivalent in farmer credit for disbursement during 2013–2018.

Source: ADB.