



# Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 23-May-2019 | Report No: PIDC27008

**BASIC INFORMATION****A. Basic Project Data**

Country Nepal	Project ID P170215	Parent Project ID (if any)	Project Name Rural Economic and Enterprise Development Project (P170215)
Region SOUTH ASIA	Estimated Appraisal Date Dec 06, 2019	Estimated Board Date Jan 31, 2020	Practice Area (Lead) Agriculture
Financing Instrument Investment Project Financing	Borrower(s) Ministry of Finance	Implementing Agency Ministry of Agriculture and Livestock Development	

**Proposed Development Objective(s)**

To enhance the ecosystem for rural entrepreneurship and to strengthen the market linkages of rural entrepreneurs, including smallholder farmers and producers.

**PROJECT FINANCING DATA (US\$, Millions)****SUMMARY**

<b>Total Project Cost</b>	170.00
<b>Total Financing</b>	170.00
<b>of which IBRD/IDA</b>	100.00
<b>Financing Gap</b>	0.00

**DETAILS****World Bank Group Financing**

International Development Association (IDA)	100.00
IDA Credit	100.00

**Non-World Bank Group Financing**

Counterpart Funding	10.00
Borrower/Recipient	10.00



Other Sources	60.00
International Fund for Agriculture Development	60.00

Environmental and Social Risk Classification

Substantial

Concept Review Decision

Track II-The review did authorize the preparation to continue

Other Decision (as needed)

## B. Introduction and Context

### Country Context

- Over the past decade, Nepal’s economy has performed reasonably well.** Growth averaged 4.7 percent (at market prices) over 2008-18. Although declining as a share in the economy, agriculture continues to play a large role, contributing over 30 percent of value-added. The service sector has grown in importance, accounting for half of value-added in recent years. Industry and manufacturing have grown more slowly and their relative share in the economy has averaged 16 percent of GDP over the past decade. Similarly, exports continue to struggle, while imports are fueled by remittances. However, remittance as a share of GDP has recently been on a declining trend due to lower oil prices that have impacted economic prospects in those countries with large Nepalese migrants. Inflation was in single digits for most of the past decade, with the peg of the Nepalese rupee to the Indian rupee providing a nominal anchor. Fiscal balances remained sustainable owing to strong revenue growth and modest spending, although recent reforms and transition to federalism has increased spending by 4 percentage points between FY2017 and FY2018 (when fiscal transfers to subnational governments came into effect). The poverty headcount ratio (at the international \$1.90 / day line) is estimated to have fallen to 10 percent in 2017 (from 15 percent in 2010<sup>1</sup>). At a higher line of \$3.20 a day, poverty is estimated at 43 percent in 2017, down from 51 percent in 2011, indicating widespread vulnerability. According to the 2018 Multidimension Poverty Index (MPI), about 29 percent of Nepal's population is multidimensionally poor. However, these gains remain vulnerable to shocks and setbacks, as evidenced by the 2015 earthquakes, which were followed by trade disruptions resulting in GDP growth of 0.6 percent in 2016, the lowest in 14 years.
- Data released by the Central Bureau of Statistics (consisting of a revision of the FY2017 growth rate and an updated estimate for FY2018), show that growth has been strong, despite the external shock from floods.** In mid-August 2017, the worst flood in decades destroyed 64,000 hectares of standing crop, contributing to an estimated reduction in the agriculture growth rate from 5 to 2.8 percent (in FY2017 and FY2018 respectively). This contributed to a reduction in overall GDP growth from 7.9 to 6.3 percent in FY2018. Government revenue continued to perform well but spending also picked up significantly in FY2017 compared to previous years. Nevertheless, ambitious expenditure targets envisioned in the budget have not been met and the quality of spending has not improved with 60 percent of capital spending occurring in the last quarter. Also, spending pressures increased in FY2018 due to fiscal transfers, as well as

<sup>1</sup> Poverty data were last updated in 2010. The World Bank will be collaborating with the Central Bureau of Statistics to update national poverty estimates using the Annual Household Survey data (2013/14 – 2016/17) and prepare the next Nepal Living Standard Survey.



spending on elections, capital goods and the transition to federalism. High inflation in the past two years has moderated sharply due to moderating inflation in India and improving supply side constraints.

3. Inflation slowed to 4.2 percent (y-o-y) in December 2017 but increased to 6 percent (y-o-y) in March 2018 owing to a sharp uptick in vegetable prices. Meanwhile, credit growth slowed to 16.7 percent (y/y) in early 2018 compared to its peak of 31.9 percent in 2017; but growth in savings deposits continued to decline, pushing up interest rates. On the external side, the cumulative effect of a sharp trade balance deterioration and a slow growth of remittances is putting significant pressure on the current account. Economic activity, impacted by the worst floods in decades, affected agriculture output. This contributed to the slowdown in growth from its peak of 7.9 percent in FY2017 to an estimated 6.3 percent in FY2018.
4. **A new government, backed by an unprecedented majority in Parliament, took office on February 15, 2018.** This follows successful elections for all three tiers (local, state and federal) of the new state architecture defined by the 2015 constitution, marking a protracted-but-successful conclusion of a political transition that began with the signing of the Comprehensive Peace Agreement in November 2006. State governments largely mirror the coalition at the center. At the sub-national level, funds, functions and functionaries hitherto managed by the central, district and village authorities are moving to the seven new provinces and 753 local governments for which new legislation, institutions and administrative procedures are being formalized as constitutionally prescribed. Meanwhile, the central level authority is being streamlined with a focus on national policies and oversight.

#### Sectoral and Institutional Context

5. As stipulated in the Sustainable Development Goals (SDGs) strategy of the Government of Nepal (GoN), **Nepal aspires to emerge as an inclusive, equitable, and prosperous middle-income country by 2030.** It intends to graduate from the status of a least developed country to that of a developing country by 2022, and onward to the standard of a middle-income country by 2030<sup>2</sup>. Similarly, the 14th periodic plan for 2016-2019 sets a goal to alleviate poverty through high economic growth with employment and fair distribution.
6. With the foreseeable challenges in setting up and implementing the new division of powers and decentralized fiscal system, as well as heavy fiscal demands to achieve these ambitious goals under the federalism, there is an increasing need to leverage private sector investment (**Maximizing Finance for Development (MFD)**). The MFD approach is critical to support the strategic goals spelled out in the SDGs and the 14th periodic plan.
7. While poverty related indicators show the overall improvement of the country, Nepal's growth has been **regionally inequitable**. **Poverty in rural areas** stands at 35% and is higher than that in urban areas at 10%<sup>3</sup>. In the rural area, the **agriculture sector** employs 86 percent of poor people making growth and value addition in the sector critical for poverty reduction<sup>4</sup>. A majority of youth workers (75% of female youths and 50% of male youths) in the rural areas are also engaged in the agriculture sector<sup>5</sup>. Male outmigration from the rural area might influence changes in women's work and roles in agriculture as well as changes in intra-household decision-making, where women can take the role of a primary farmer but still continue lacking adequate access to finance, market and tailored extension services to move up in the value chain<sup>6</sup>.

<sup>2</sup> Policies and Programs of the Government of Nepal for Fiscal Year 2072-73 (2015-16) Presented by Rt. Hon. President, Dr. Ram Baran Yadav at the Meeting of the Constituent Assembly/Legislature-Parliament

<sup>3</sup> Central Bureau of Statistics (2011), "Nepal Living Standard Survey"

<sup>4</sup> World Bank (2018), "Systematic Country Diagnostic"

<sup>5</sup> World Bank (2018), "Youth Employment in Nepal"

<sup>6</sup> Kar et al. (2018)



8. **Growth in agriculture has been low and volatile**, driven by higher relative prices for agricultural commodities and favorable monsoons rather than any growth in productivity<sup>7</sup>. While there are opportunities for growth by developing commercialized and high value agriculture<sup>8</sup> (tea, spices and vegetables) and there is a sizable domestic market for most food segments, the sector is not adequately tapping into these opportunities. Growth in traditional sectors (rice, maize, potatoes) has been flat with productivity well below regional benchmarks. Agriculture exports have also been flat over while agricultural imports (predominantly from India) have been rising creating over a \$1 billion agri. related trade deficit. The 2014 Agriculture Development Strategy (ADS) for 2015-2035 provides a comprehensive roadmap for creating “a sustainable, competitive, and inclusive agricultural sector that drives economic growth” and it recognizes the private sector as the principal actor in the sector’s transformation. However, at present, **private sector growth remains stunted**<sup>9</sup>.
9. With regards to **the non-farm sector, rural household income from non-farm activities is on an increasing trend** (from 16 to 37 percent over the 1995-2011 period)<sup>10</sup>. The rural non-farm sector provides employment for 29 percent of rural workers in Nepal and over 50 percent of rural wage labors and salaried workers are engaged in rural non-farm activities<sup>11</sup>. The rural non-farm sector constitutes all income-generating economic activities that take place in the rural space, other than primary agricultural production<sup>12</sup>. This includes agro-processing, transport, wholesale, and retail, as well as other economic activities, such as tourism, handicrafts, textiles, construction, and other rural services (e.g. mechanics, IT and telecom services, etc.). Among rural non-farm enterprises in Nepal, wholesale and retail trade (mainly related to agricultural products) account for 29 percent and manufacturing of food products accounts for another 17 percent<sup>13</sup>. Other major rural non-farm enterprises include: agriculture related activities (7 percent), textiles (7 percent), manufacturing of wood and wood products (7 percent), forestry and logging related activities (5 percent), hotels and restaurants (4 percent), transport (3 percent), and construction (3 percent). The majority of rural non-farm activities are therefore largely, but not exclusively, related to agriculture.
10. **Stimulating the non-farm economy in rural areas of developing economies is considered an important step towards structural transformation for economic growth**. Recent assessments have identified non-farm sub-sectors with strong potential for economic growth and job creation, among which the most promising include agribusiness, tourism, light manufacturing (artisans/handicrafts, fiber, and textiles)<sup>14</sup>, IT-services, and construction and related services<sup>15</sup>. The country partnership framework (CPF) of the World Bank also strongly stressed the need for promoting agribusiness and tourism for rural growth and employment. In recent years, the services sector has grown in importance, accounting for more than half of value-add. IFC’s recent deep dive analyses for the Country Private Sector Diagnostic for Nepal (CPSD) (2018) highlighted a strong growth potential for the tourism sector and the IT services sector, which can expand good job opportunities for skilled youth, especially leveraging the low-wage advantage. In the context of high male

<sup>7</sup> World Bank. 2016. “Source of Growth in Agriculture”.

<sup>8</sup> World Bank (2018) “Country Private Sector Diagnostics”

<sup>9</sup> World Bank (2018), “Agribusiness Deep Dive”.

<sup>10</sup> Central Bureau of Statistics (2011), “ Nepal Living Standard Survey”

<sup>11</sup> Central Bureau of Statistics (2011), “ Nepal Living Standard Survey”

<sup>12</sup> The World Bank.2016.”Growing the Rural Non-Farm Economy to Alleviate Poverty Report”. The Nepal Enterprise Census 2018 also covered only non-farm enterprises and excluded the non-registered establishments which belong to “Agriculture, forestry, and fishery” (Section A) of International Standard Industrial Classification (ISIC) Rev.4.

<sup>13</sup> Central Bureau of Statistics (CBS). 2011. “The Nepal Living Standard Survey”

<sup>14</sup> ODI (2017), “Supporting Economic Transformation- Nepal”

<sup>15</sup> World Bank(2017), “ Assessment of Business Development and Livelihood Enhancement in Earthquake affected districts of Nepal”



outmigration from rural areas, agricultural machinery services and agricultural transportation also have potential for creating job opportunities and promoting productivity of women engaged in agriculture in the rural areas<sup>16</sup>.

11. **Limited access to financial services, both at household and firm/enterprise level, is a critical constraint for development of the agriculture sector.** A recent study has shown, a percentage change in agricultural credit flow of commercial banks will bring, on average, a 0.183 percent change in the agricultural gross domestic product (AGDP).<sup>17</sup> Outstanding agriculture credit of formal financial institutions accounts for 5.6 percent of total outstanding credit, which is amongst the lowest in the South Asia Region (SAR). An estimated 70 percent have no access to institutional finance but rely only on informal sources of finance or are financially excluded. Agriculture insurance penetration is very low, accounting for 2.2 percent of the total non-life insurance premium volume, and sum insured being less than 10 percent of the total outstanding agriculture credit in 2017. Livestock insurance accounts for the bulk (78.8 percent) of the total agriculture insurance premium, followed by poultry (12 percent), and crop (5.2 percent). Similarly, **access to finance for Small Medium Enterprises (SMEs) including agribusinesses, remains a constraint.** Nearly 40 percent of Nepalese firms identify access to finance as a major constraint, the highest in SAR. The collateral requirement (i.e. 364 percent of loan amount by financial institutions in Nepal for accessing loan) is also the highest in SAR and only 17 percent of firms have used bank loans to finance investments.<sup>18</sup>
12. Preliminary findings of the WB's Agriculture Finance policy note identified opportunities to expand financial products to meet the needs of the agriculture sector to include warehouse receipt financing, crop and livestock insurance, as well as the need for restructuring of the existing credit guarantee funds<sup>19</sup>. Also, there has been an uptick in both agriculture credit, and insurance. Agriculture credit by financial institutions<sup>20</sup> increased by 28 percent in 2018 compared to the previous year, similarly agriculture insurance premium volume grew by 35 percent in the commensurate period (2018 vs. 2017)..
13. While the GoN envisages the expansion of SMEs as one of development priorities for job creation and economic development (14<sup>th</sup> Development plan), the growth of SMEs has been slow. Constraints hindering the growth of SMEs include weak downstream linkages<sup>21</sup>, a regulatory framework which undermines the competitiveness of SMEs, limited access to financial services, poor support services for SMEs, and challenging logistics. Slow expansion of SMEs **limits the potential development of job-creating value-adding activities**, and stymies **profitable linkages** with small-holder producers<sup>22</sup> and other SMEs. Global evidence shows that strong forward and backward linkages are associated with high employment multipliers through the creation of direct and induced jobs in related enterprises. Multipliers range from 3 to 25 indirect jobs for every direct job created, with job multipliers even higher for the agro-processing sector (IFC, 2013). Furthermore, agro-processing firms are also characterized as a significant employer of women, often ranging from 50 to 90 percent of employees (WB, 2008). Therefore, job creation in agro-processing value-chains **creates more opportunities for women to participate in the workforce**, and often in skilled and supervisory roles.
14. **Creating an inclusive entrepreneurship ecosystem is critical to generate the enterprises of tomorrow that will absorb the growing working age population. Job and entrepreneurship opportunities for large sections of the economically active**

<sup>16</sup> World Bank (2018), "Male outmigration and women's work and empowerment in agriculture : the case of Nepal and Senegal"

<sup>17</sup> Narayan Rima (2014), "Agricultural Credit flow of Commercial Banks and Impact on Agricultural Production in Nepal", Sch. J. Arts Humanities Soc. Sci. 2014; 2(2C):372-376

<sup>18</sup> World Bank (2013), "Enterprise Survey"

<sup>19</sup> to be completed in FY19 by FCI +Ag GP

<sup>20</sup> Financial institutions including commercial banks, development banks, and finance companies.

<sup>21</sup> The World Bank's Enterprise Survey (2012) indicated that informal enterprises are predominantly micro firms, while their downstream linkages to other firms (formal or informal) are limited, hindering the sector's ability to play a role in the supply chain for the formal sector.

<sup>22</sup> On Agriculture sector, refer to World Bank (2016), "Enabling the Business for Agriculture".



**population, particularly youth and women, however, remain limited.** This is closely linked to the enabling ecosystem for innovation, entrepreneurship and incubation at the individual level and at the economy-wide level, and limited services delivery that underpin development of new economic opportunities. While migration is a common phenomenon among youth workers in rural Nepal, remittances are largely spent on high rates of consumption out of remittances, rather than productive investments, which may reflect a lack of investment opportunities and undeveloped financial markets<sup>23</sup>. While important accelerators and incubation initiatives have recently emerged (e.g. Nepal Agribusiness Innovation Center (NABIC) and Kathmandu Management School), these remain concentrated around Kathmandu and opportunities to use disruptive technology to decentralize such services remains unexplored. There is currently limited contact between traditional industry and technology-enabled startups in Nepal, a missed opportunity for both sides. Firms in major employment generating sectors such as agriculture or manufacturing have not yet absorbed the benefits from technology, and technology enabled firms are not creating solutions that respond to their specific needs. Constraints faced by women entrepreneurs – who dominate the rural non-farm employment space – are especially severe. Considering that the SDG strategy reconfirms Nepal’s commitment to closing the gender, social group, and geographical location-related development gaps and moving towards shared prosperity for all its citizens, creating inclusive entrepreneurship ecosystem is critical.

15. While **the transition to the federal structure** is expected to result in improved outreach and service delivery in the medium term, it is likely to take time before becoming fully operational. For instance, the Agriculture Development Strategy (ADS) was developed prior to the federalism transition and requires a customization to the federal context. The schedule of powers across three tiers of government (Federal, Provincial and Local Level Governments) within the agriculture and rural sector remains unclear, nor is it well understood among the staff of the governments. Capacity of the decentralized governments remain limited to exercise the decentralized responsibilities. **Strengthened capacity of the Provincial and Local governments, beyond fiscal decentralization, is a key building block to create an enabling ecosystem for SME growth, entrepreneurship development and to promote private sector participation in the agriculture and rural sector.**
16. **Broad-based rural economic development requires both the growth and enhanced competitiveness of Nepal’s rural-based value chains<sup>24</sup>, to employ the majority of the rural population today, while supporting the ecosystem of entrepreneurship and enterprises to generate the job opportunities of tomorrow.** These twin goals can be complementary as the growth and competitiveness of rural based value chains depends not only on sustainable linkages with larger national and global markets, improved service provision from farm and non-farm value chain actors, and strong efficiencies along the value chain, but also on an ecosystem of enterprises to deliver technology, services and new business models that can elevate the value chain to new levels. This requires active engagement between established players and new participants and an enabling environment to facilitate these relationships and strengthen those links. To create this, Nepal can adopt an MFD approach at provincial and local government levels that provides the right policy and regulatory environment, mechanisms to enable and strengthen key value chain linkages while supporting new models that deliver critical inputs such as access to finance and knowledge/technology transfer. These actions will help to strengthen rurally based value chains and the ecosystem that supports the growth of those value chains.
17. Promoting rural economic growth has been a priority for the GoN, which has been implementing a number of programs to promote rural economic growth and to alleviate rural poverty. Some programs created rural job opportunities through support to producers and SMEs, such as Micro Enterprise development for Poverty Alleviation (MEDPA) and the IDA-funded Project for Agriculture Commercialization and Trade (PACT). Others aimed to alleviate rural poverty

<sup>23</sup> ICIMOD(2018), “Approaches to Productive use of Remittances in Nepal”

<sup>24</sup> For the purposes of this project document, “rural based value chains” are value chains which source a significant portion of their inputs from rural areas and/or enterprises based in rural areas and/or service enterprises with a strong rural clientele”.



through income generation activities, such as Local Governance and Community Development Program (LGCDP) and the IDA-funded Poverty Alleviation Fund (PAF).

18. **Building on the country's experiences and long-term vision, Nepal has an opportunity to invest in a broad-based and inclusive economic growth in supporting rurally based value chains** to achieve an inclusive, equitable and prosperous middle-income country status. The sustainable development of agribusiness and other rurally based value chain actors can make a significant contribution to rural economic development in Nepal, while maintaining a strong inclusion agenda. Under the new federal structure, Nepal has an opportunity to **"federalize an MFD approach"** with participation of the private sector to attain rural economic growth envisaged in the development goals of the provincial and local level governments (LLGs) in line with the national vision.

#### Relationship to CPF

19. The **proposed project is consistent with the Nepal Country Partnership Framework (CPF) covering the period of FY19-24.** It will contribute to : (i) CPF Focus Area 1 (Federalism) by supporting local governments with their efforts towards improved rural services and their delivery to rural entrepreneurs (including smallholder farmers); (ii) CPF Focus Area 2 (Jobs, Growth and Private Sector) by helping the central, provincial and local governments develop a business climate conducive of private sector investment in rurally based value chains; and (iii) CPF Focus Area 3 (Inclusion and Resilience) by promoting enterprise development and job creation in an inclusive manner, expanding productive economic opportunities in rural areas, including for youth, women, and marginalized groups.

#### C. Proposed Development Objective(s)

20. The PDO is to enhance the ecosystem for rural entrepreneurship and to strengthen the market linkages of rural entrepreneurs, including smallholder farmers and producers.

#### Key Results

21. **Key Performance Indicators.** The following PDO-level indicators will be used to monitor the key outcomes of the Project:
- Increase in gross revenue of *the target beneficiaries* (detailed in C. Project Beneficiaries)
  - Productive Partnerships in rurally based value chains established and operational
  - Total amount of private sector funding mobilized (including beneficiary contribution to matching grant, commercial loans by Financial Institutions, direct investments);
  - Number of Direct and Indirect Beneficiaries (with share of women, youth)
  - Number of target beneficiaries with a developed innovation<sup>25</sup>;

#### D. Concept Description

##### Project Components

##### **Component 1: Strengthening Market Linkages through Productive Partnerships (US\$ 95 million)**

22. **Rationale and objectives.** Component 1 capitalizes on the lessons learned from the global and local experience with the concept of **Productive Partnerships (PPs)**. The approach aims to promote the development of sustainable business

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<sup>25</sup> According to Corporate Results Indicators, a 'developed' innovation will be measured as the number of businesses receiving advisory services and/or technical assistance through the Project that develop new/innovative business models resulting in the development of new products and/or processes or the enhancement of existing products and/or processes in their operations.





partnerships between stakeholders (rural entrepreneurs and their buyers). Further, to support the sustainability and scale up of the PPs, the component 1 nurtures additional rural entrepreneurs as future pipeline for PPs. Component 1 is at the core of the project's **MFD-enabling agenda**.

23. The objectives of this component are: (i) to link rural entrepreneurs—with market opportunities through PPs; (ii) to finance and support PPs; (iii) to support last-mile infrastructure; and (iv) to build pipeline of future PPs.

#### **Subcomponent 1.a Building Productive Partnership to promote rural-based value chains**

24. This sub-component aims to support rural entrepreneurs to establish and strengthen commercial linkages with qualified buyers and end-markets by building “**Productive Partnership (PP)**”. PP specifically targets rural entrepreneurs in order to aggregate products and services;
25. In accordance with “**Market Discovery approach**”, PPs will be established through: (a) communications campaign; (b) facilitation and brokerage by the Project Implementation Unit (PIUs) to support rural entrepreneurs/buyers to develop joint business proposals; (c) identification of viable joint business proposals between rural entrepreneurs and buyers, (d) providing support for business plan formulation; (e) selection of financially and technically viable plans on competitive basis by an independent entity
26. Once business proposals are selected, rural entrepreneurs will receive **technical assistance, capacity building and financial support** from the project to aggregate efforts in production and services and basic technical transformation, enhance the quality as per the demand of the buyers and develop/enhance entrepreneurial skills and business management. Agreements between rural entrepreneurs and buyers will specify the quantity, quality, delivery and price determination parameters. Technical support for rural entrepreneurs will be tailored to achieve this agreed specification. Collective action and aggregation will allow rural entrepreneurs to reduce production costs, achieve market standards and improve commercialization. By the same token, buyers reduce transactions costs related to aggregation, quality assurance, and consistency of delivery.
27. Financial support to these rural entrepreneurs will be made available via a financing instrument (or a combination of multiple mechanisms) identified during the assessment of needs vis a vis market failures and gaps to be realized during project preparation. These mechanisms could include a combination of financing instruments such as blended loans (that comprise of financing from the project, financial intermediary and equity from rural entrepreneurs), stand alone commercial loans or loans with selected financing institutions backed by a risk-sharing guarantee from the project, partial, matching grants and equity contribution from beneficiaries.

#### **Subcomponent 1.b Supporting Infrastructure to support Productive Partnerships**

28. This sub-component will also include an infrastructure envelope that will invest in small public good infrastructure to enable the sustainability and creation of more Productive Partnerships to pave the way for connectivity, access and scale up. The nature of public infrastructure supported will range from rural and agricultural roads, small scale irrigation schemes, rural bridges and market infrastructure. These infrastructure investments will be selected based on their relevancy to the potential productive partnerships or aggregations thereof, in accordance to national and local level policies critical to rural economic growth.

#### **Subcomponent 1.c Building pipeline of future PPs**



29. This subcomponent will build a pipeline of potential PPs by nurturing additional rural entrepreneurs through **business incubators and accelerators** and by linking them to buyers identified through PPs established under component 1.a. These buyers will be selected among those that have proximity to market and market information and are innovators and respected thought leaders in their industries.
30. These rural entrepreneurs, identified by buyers as potential business partners, will be mapped to the selected accelerators/incubators who will assist them by building their market and investment readiness by improving technical and managerial capacity which includes but is not limited to, production/resource efficiency, technology and business model, industry expertise, corporate governance, legal and statutory compliance, financial management, quality of assets, appropriation of internal rate of return, and enhancing team capability. In addition, they will also be linked to start-ups and Intermediary Institutions from sub component 2.b. to facilitate technology adoption (e.g. ICT, Climate Smart Ag Tech, Digital Agriculture).
31. To support the rural entrepreneurs, financial and technical assistance will be provided to strengthen and expand the existing **business incubators and accelerators** (e.g. Nepal Agriculture Business Innovation Center-NABIC) and those hosted by business associations and universities (e.g. KTM Management School) by establishing branches in secondary cities which are identified to have intensity of enterprises and business establishments<sup>26</sup>. Support to business incubators/accelerators will be provided on a competitive basis and will include performance-based funding for setting up branches and expanding the reach to rural/semi-urban entrepreneurs.

***Component 2: Creating Ecosystem to strengthen market linkages and to promote entrepreneurship (US\$ 60 million)***

32. **Rationale and Objectives.** While the transition to the federal structure is rapidly progressing in Nepal, the schedule of powers across three tiers of government (Federal, Provincial and Local Level Governments) within the agriculture and rural sector remains unclear nor well known among the staff of the governments. Agriculture Development Strategy (ADS) was formulated prior to the federal structure and has not been yet revised. Capacity of the decentralized governments remain limited.
33. Component 2 aims to lay the foundations for creating ecosystem to strengthen market linkages established by PPs under Component 1, to promote entrepreneurship to sustain the growth of the PPs and to support the PPs and broader agribusiness sector with financing. Component 2 also aims to support the transition to federalism by “**federalizing an MFD approach**”. It aims to improve an environment conducive of private sector participation in strengthening market linkages of the rural -based value chains in the decentralized context.
34. The objectives of this component are (i) to strengthen regulatory framework and institutional capacity in the federal structure; (ii) to support infrastructure to enhance opportunities for market access and trade; (iii) to build capacity of Intermediary Institutions in Startup Ecosystem; and (iv) to structure financing and support financial product development to support PPs of Component 1.

**Subcomponent 2.a Strengthening regulatory framework and institutional capacity in the federal structure**

35. This subcomponent will strengthen key regulatory and institutional framework through **Disbursement Linked Indicators (DLIs), capacity building of the concerned public agencies, incentive mechanism for decentralized governments, and infrastructure support** for market access and trade.

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<sup>26</sup> To be identified by SME survey (on-going) and by Economic Census (2019).



36. **DLIs** will be developed to strengthen the regulatory and institutional framework to underpin, reinforce, support and in some case, create, an ecosystem to strengthen market linkages established by PPs under Component 1, to promote entrepreneurship to sustain the growth of the PPs. During preparation, a comprehensive review will be conducted to identify key policies and regulatory and institutional framework as well as key services, which are critical to strengthen market linkages established by PPs and to promote entrepreneurship to support PPs. Key policies could include Agriculture Development Strategy (ADS), Agribusiness Promotion Act (draft), National Start-up policies, and key services could include market information advisory services, regulatory services (including Sanitary and Phyto-sanitary (SPS) agenda<sup>27</sup>, food safety), support services (including, agro-logistics). These diagnostics will identify gaps in both in service deliveries and regulatory and institutional framework to support the expansion and sustainability of PPs.
37. **Institutional capacity and skill development program** will be designed and rolled out to help strengthen the capacity of both federal and decentralized government agencies to support the development and upgrading of rural based value chains. Considering the importance of SPS agenda to promote trade, the envisaged capacity development could include technical training for the newly established fumigation chamber and quarantine facilities at MOALD; support to the Department of Food Technology and Quality Control, as well as overall capacity of the relevant offices of the provincial governments for food safety. During preparation, diagnostics will be conducted to clarify **the distribution of functions and funding across government levels** for selected key agricultural and rural services and policies, which are critical to strengthen the rurally-based value chains. Then, **institutional capacity enhancement needs assessment (CENA)** will be carried out to identify the major constraints faced by the concerned decentralized public agencies with the delivery of the selected agricultural rural services or with the policy/regulatory framework formulation.
38. Further, the sub-component incentivizes decentralized governments to align their design of regulation and policy framework with national priorities. This is critical since the decentralized governments are now in charge of new legislation, institutions and administrative procedures, this incentive work is important to ensure decentralized entities do not err in the direction of over-regulation, duplication, contradiction, crowding out, and etc. During preparation, the sub-component will provide technical support of the design of an incentive system, anchored in inter-governmental co-financing schemes or in the form of conditional budget allocation from federal government to decentralized governments.
39. The sub-component will also **support infrastructure to enhance opportunities for market access and trade**, particularly food safety, SPS and quarantine facility, which will now fall under the responsibility of the decentralized governments. Specific attention will be given to investments with clear potential for outsourcing the day-to-day operation and management of these structures to national private sector companies. These may include post-harvest logistics, warehousing, processing and manufacturing facilities, and others.

#### Subcomponent 2.b Capacity Building of Intermediary Institutions in Startup Ecosystem.

40. The sub component will enhance the sustainability and the scale of the PPs established under Component 1 by developing a pool of entrepreneurs and startups who will serve as **service providers** to the PPs. The sub-component will strengthen the entrepreneurship ecosystem that can support entrepreneurs by leveraging existing local initiatives; address the existing gaps in the connection between target entrepreneurs and this ecosystem; and address gaps in the support services.

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<sup>27</sup> Bank's Nepal Agribusiness Deep Dive and Agriculture Sources of Growth highlighted SPS as one of key barriers for trade promotion of Nepali agri and food products.



41. The direct beneficiaries of this component will be **Intermediary Institutions which can be public, private, and non-profit organizations that deliver services to actors of the entrepreneurial ecosystem** such as technology centers, innovation centers, incubators, accelerators, business support organizations, tech hubs, technology commercialization offices, large firms, and industry associations. The end beneficiaries will be the entrepreneurs and startups, receiving services from the Intermediaries, who can provide services to the PPs and other rural based value chains. Priority will be given to those intermediaries who are serving rurally based value chains as incentive to promote entrepreneurship to support PPs. These institutions engage in activities that are largely public good element in terms of creating market for technology entrepreneurs and facilitating technology adoption in traditional sectors, thus depends on financial support from governments and development organizations.
42. The subcomponent will finance competitively awarded results-based performance contracts to Intermediary Institutions. As a first step, there will be an active outreach to Intermediaries to solicit applications. This will be done through media outreach, a public call for expressions of interest, and the proactive screening of Intermediary Institutions. The outreach will particularly encourage Intermediary Institutions providing support services to technology entrepreneurs (**digital and climate smart technologies**) with focus on rural area to develop digital platform. Winning proposals will be receiving funding in tranches and the payments will be conditional on deliverables and result targets which will be set for each Intermediary Institutions based on the initial contract. Result based performance contract will allow implementing entity to be flexible and adaptable needed to grow technology markets, compared to other instruments which pre-sets a specific set of milestones to be met.

#### **Sub-Component 2.c. Promoting access to finance for rural entrepreneurs**

43. Unlocking the financing gap in agribusiness will be critical to addressing both the financial needs/viability of the PPs supported under component 1 as well as the broader financial products required to support improving productivity and achieving growth of agribusiness value chains. The financial support to rural entrepreneurs will primarily take the form of matching grants, while at the same time using the matching grant to leverage commercial financing from formal financial institutions. During the project preparation a concerted effort will be made to evaluate existing linkages between rural entrepreneurs and buyers to a) understand the structure of those linkages and related financial gaps and the challenges/willingness of financial institutions to extend credit to those types of structures; b) get an estimate of the leverage ratio namely ratio of financing from commercial sources viz-a-viz project funding for the potential PPs; and c) risk mitigation needs for financial institutions to support the PPs. In addition, a review will be conducted to assess financial capacity of producer organizations/cooperatives. These reviews will build on Agriculture Finance Strategy Policy note (forthcoming) and existing analytical pieces on Credit Guarantee schemes, insurance and etc..
44. Based on the above diagnostics, the project may consider several potential interventions to support financial instruments for PPs, which could include, i) supporting the setting-up a partial credit guarantee facility/first-loss default guarantee (FLDG)<sup>28</sup>; and ii) support scaling-up of agriculture insurance, both of which could help de-risk financial institutions from lending to the agriculture sector.

#### **Component 3: Project Management (US\$ 15 million)**

45. This component covers the activities of the Federal-level Project Management Unit (PMU) and Provincial-level Project Implementation Unit (PIU) set up by the GoN during the project preparation phase. The Federal-level PMU will be

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<sup>28</sup> A first-loss default guarantee (FLDG) makes the provider of the guarantee liable to bear losses up to a certain specified limit, say the first 10 or 20 per cent of loss on the portfolio. It is different from partial guarantees, where the guarantor is liable for a fraction of losses, say 50 percent of all losses on the portfolio.



responsible for overall supervision, quality assurance and M&E, Coordination with other relevant Ministries as well as Coordination and implementation of policy and regulatory framework related issues. The Provincial-level PIU will be responsible for the day-to-day operations of the project, facilitation, monitoring, fiduciary supervision and safeguards management as well as for the institutional coordination among the various agencies involved with the project activities at local level. The staff of PMU/PIU should comprise of professional experts to be selected competitively on a merit-basis and be paid at market-rate, and if possible on mile-stone basis. Evaluation of business plans and proposals under Component 2 and 3 should be done by independent professional agencies that are familiar with the private sector and the agricultural and rural market opportunities.

46. During preparation, Implementation Arrangement will be identified in consultation with the counterpart Ministry(ies). Considering the project’s focus on the agriculture and rural development sector, initial discussions with the GoN authorities indicates that the project will be coordinated and implemented by the Ministry of Agriculture and Livestock Development (MoALD) at State Level, who is expected to coordinate closely with other relevant Ministries, notably Ministry of Industry (Mol), Ministry of Land Management, Cooperatives and Poverty Alleviation (MoLCPA). At provincial level, Provincial Ministry of Land Management, Agriculture & Cooperative is expected to implement activities in coordination with Provincial Ministry of 'Industry, Tourism, Forest & Environment'.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

#### Summary of Screening of Environmental and Social Risks and Impacts

As per the initial concept identified project activities /sub-projects the following key risks have been identified:

- land slide and slope stability issues with regard to rural infrastructure
- water right issues
- pollution, pesticides and hazardous chemical management
- physical resettlement, economic displacement and land acquisition
- labour related issues
- community health and safety issues

**Note** To view the Environmental and Social Risks and Impacts, please refer to the Concept Stage ESRS Document.

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**APPROVAL**

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