



Technical Assistance Report

Project Number: 49273-004
Transaction Technical Assistance (TRTA)
November 2020

Sri Lanka: Value Chain Development for Tea Sector

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 10 November 2020)

Currency unit	–	Sri Lanka rupee/s (SLRe/SLRs)
SLRe1.00	=	\$0.0054
\$1.00	=	SLRs184.5000

ABBREVIATIONS

ADB	–	Asian Development Bank
COVID-19	–	coronavirus disease
JFPR	–	Japan Fund for Poverty Reduction
SMEs	–	small and medium-sized enterprises
TA	–	technical assistance

NOTE

In this report, “\$” refers to United States

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I. THE PROPOSED PROJECT

1. The Asian Development Bank (ADB) will provide additional financing of \$166.25 million to the ongoing Small and Medium-Sized Enterprises (SMEs) Line of Credit Project in the Democratic Socialist Republic of Sri Lanka under the proposed project. The additional financing will comprise (i) a \$45 million ADB loan to support targeted underserved SMEs (SME component), (ii) a \$20 million ADB loan to support tea smallholders and a \$1.25 million attached project grant provided by the Japan Fund for Poverty Reduction (JFPR) (pilot component),¹ and (iii) a \$100 million ADB loan to provide short-term liquidity support for SMEs in response to the coronavirus disease (COVID-19) (emergency response component).

2. In addition, an attached JFPR technical assistance (TA) grant of \$1.75 million for value chain development for the tea industry will be integral for implementing the pilot component.

3. The impact and outcome of the current project will be retained. The impact of the overall project will be increased employment opportunities in SMEs. The outcome will be strengthened SMEs' access to finance. The project outputs will be (i) financing to SMEs through formal intermediaries increased; (ii) innovative SME financing schemes developed; (iii) capacity of SMEs in targeted clusters to access financial services enhanced; (iv) international competitiveness of the information and communication technology–business process outsourcing and tea cluster strengthened; (v) gender-inclusive policy and regulatory framework and support enhanced; and (vi) evidence based on women entrepreneurship development to inform future policy making strengthened. The pilot component and JFPR TA will support project outputs 1, 3, and 4.

4. **Support for tea smallholders.** In Sri Lanka, the tea industry has been an important part of the socioeconomic fabric, with significant macroeconomic policy implications in terms of earning foreign exchange and promoting inclusive economic growth. It accounts for 15% of exports and employs 10% of the workforce, most of whom are less educated with chronically low wages. Some 75% of tea production depends on more than 400,000 tea smallholders, most of whom have informal family businesses with landholdings of less than 0.4 hectares (1 acre).² Despite its brand recognition, Sri Lankan tea has recently been losing its international competitiveness because of the declining quality and quantity of tea leaves resulting from aged tea bushes and lack of technological upgrading of agricultural practices, including climate change adaptation. The current replanting rate of the tea smallholding segment is only 0.7%, while the ideal rate is 2%–3%.³

5. Tea smallholders are generally unbanked. Although they are eligible to borrow from the ongoing ADB SME credit line, only one tea smallholder has done so while tea processing factories have accessed it to modernize and upgrade their facilities.⁴ The underinvestment by tea smallholders in replanting, business upgrading, and other productivity enhancement measures is caused by the following issues: (i) their limited access to formal long-term financing; (ii) their

¹ Japan Fund for Poverty Reduction Grant (accessible from the list of linked documents in Appendix 2 of the report and recommendation to the President).

² Following the definition of smallholding by the Ministry of Plantation, tea growers with a landholding not exceeding 20.2 hectares (50 acres) are considered tea smallholders.

³ Replanting takes 2–3 years for soil rehabilitation before planting. Tea plants take 18–36 months after planting to start yielding pluckable tea. Thereafter, productivity follows a continuous parabolic curve, growing to yield the highest crop typically around the age of 8 years. Yield stays fairly stable until the age of 40–50 years, then productivity starts declining rapidly. To match this yield curve, a long-term loan with sufficient grace period is needed for replanting.

⁴ The only subloan provided to the tea smallholding segment for new planting and replanting was blended with the Women Entrepreneurs Finance Initiative grant. For the tea factory segment, 22 tea factories employing 3,736 people had borrowed around \$2.7 million under ADB's credit line as of April 2019.

limited access to training, knowledge of good agricultural practices, technology, and market information; and (iii) ineffective policy frameworks to strengthen the industry's international competitiveness.⁵

6. The attached JFPR project grant will financially support marginal tea smallholders with landholdings of less than 4 hectares (10 acres) to access bank financing for replanting and new planting, by providing 10%–20% principal paydown to subloans under the pilot component to directly address issue 1 (tea smallholders' limited access to formal long-term finance). The attached JFPR TA will provide capacity enhancement for key stakeholders along the tea value chain to develop an enabling environment for addressing issues 1–3 and to strengthen the international competitiveness of the Sri Lankan tea industry.

II. THE TECHNICAL ASSISTANCE

A. Justification

7. The new \$1.75 million JFPR TA will support the measures to improve tea smallholders' productivity and international competitiveness. This will mitigate the demand risk for the pilot component during project implementation and lay a foundation for sustainable development of the tea industry beyond the project implementation period. This transaction TA is listed in the current country operations business plan.⁶ The government confirmed this transaction TA through an aide-mémoire in February 2020.

B. Outputs and Activities

8. **Output 1: Improving tea smallholders' access to finance.** This output will promote the blended finance under the pilot component by (i) providing financial literacy trainings to tea smallholders through tea societies, in cooperation with banks, to alleviate the risk of tea smallholders' overindebtedness from informal lenders; and (ii) supporting participating banks to develop a standardized loan product dedicated to tea smallholders to decrease their loan origination and administrative costs in cooperation with tea factories and tea societies.

9. **Output 2: Developing a mobile application platform for tea smallholders.** A new mobile application platform will be launched, on a pilot basis, to provide better access for tea smallholders to extension services, market information, online training, and mentorship programs; and easily maintain business and financial records.⁷ The pilot introduction of simple mobile-based services and their acceptance by users will set the foundation for full-fledged and innovative services through smartphones and/or tablets, such as product quality certification through blockchain technology along with supply chain, artificial intelligence-based extension services (e.g., chatbot), banks' internal scoring of credit to tea smallholders based on their behavioral data,

⁵ A detailed explanation of the three key issues is in the Japan Fund for Poverty Reduction Grant (accessible from the list of linked documents in Appendix 2 of the report and recommendation of the President).

⁶ ADB. 2019. [Country Operations Business Plan: Sri Lanka, 2020–2022](#). Manila. The TA first appeared in the business opportunities section of ADB's website on 13 November 2019.

⁷ Introductory financial literacy trainings will be provided through tea societies (local community-based apex body) to tea smallholders together with banks. ADB consultants recruited under the TA will develop training materials and provide support and supervision for the training delivery with the Tea Small Holdings Development Authority. Follow-up content will be uploaded to the mobile application. In terms of mentorship, the mobile application will provide (i) more frequent communication with tea inspectors, and (ii) matching services between tea smallholders to learn from each other on cultivation and access to markets.

and the development of weather index insurance.⁸ The cost and production data accumulated through the platform will provide evidence-based information for the government to formulate more targeted policy interventions.

10. This component will (i) raise awareness of the use of mobile-based services among tea smallholders, (ii) develop mobile application services, (iii) develop implementation arrangements to manage services on a sustainable basis, and (iv) evaluate the impact of the mobile-based application service on tea smallholders' business practices.

11. The mobile application will be developed primarily to meet the needs of tea smallholders, but subscription to the service will not be limited to tea smallholders. Tea factories, brokers, and banks may also benefit from the mobile application to develop stronger market linkages with tea smallholders. The ownership of the mobile platform will be transferred to the government after TA completion. The development and marketing campaign will be undertaken through participating tea factories and lead farmers in selected value chains in selected districts to ensure service outreach to tea smallholders in the same value chain. As part of the TA implementation, ADB will support the government to develop a governance and implementation framework to crowd in private sector management for installing and developing the mobile application platform on a sustainable basis.

12. **Output 3: Developing an enabling environment for a sustainable and gender-sensitive tea value chain.** This output aims to develop a white paper on sustainable value chain development, focusing on tea smallholders. As Sri Lanka undergoes the transition to middle-income status, labor costs will increase and the Sri Lankan tea industry will need to rebrand itself to export-quality tea for targeted segments of international consumers. One possible direction is to promote sustainable and gender-sensitive value chain development, with organic and fair-trade certificates for tea smallholders and tea factories. This would allow them to sell socially responsible products directly to international consumers outside the auction system.⁹ This policy research will (i) analyze the existing regulatory, budgetary, and institutional frameworks;¹⁰ and (ii) propose new policy measures to develop internationally competitive value chains, including the promotion of direct selling to the international market and women entrepreneurship development in the tea industry.¹¹

13. **Output 4: Project monitoring and evaluation.** This output will support monitoring and evaluation of the pilot component in relation to the SME component. A rigorous impact evaluation on the effectiveness of the use of the mobile-based extension service and related stakeholder dissemination will be carried out by ADB's TA. This output will also support the project

⁸ C. McIntosh and C. Mansini. 2018. [The Use of Financial Technology in the Agriculture Sector](#). *ADB Working Paper Series*. No. 872. Manila.

⁹ The adoption of sustainable farming practices is becoming increasingly important to partner with global value chains, as most leading value chain partners and consumers are becoming conscious of environmental sustainability. For instance, Unilever has partnered with the Rainforest Alliance to certify smallholder tea farmers to ensure that all the tea sourced by the company is sustainably produced. Some regional plantation companies have already taken steps to train and certify their smallholder suppliers on sustainable farming. During the TA implementation, the ADB team will seek inputs from the Rainforest Alliance and other civil society organizations that promote sustainable farming practices.

¹⁰ Institutional gaps identified for extension services by the Tea Small Holdings Development Authority and Sri Lanka Tea Board will be addressed in the mobile application service.

¹¹ The ADB gender gap assessment for the tea smallholder value chain identified potential areas for women to start new businesses, including (i) commercial nurseries, (ii) tea tourism, (iii) employment agencies, and (iv) green leaves collection.

management unit in financial management, environmental and social safeguard management, and other project management activities.

C. Cost and Financing

14. The TA is estimated to cost \$1.75 million, which will be financed on a grant basis by the JFPR and administered by ADB. The key expenditure items are listed in Appendix 1.

15. The following items are ineligible expenditures under the JFPR TA: (i) the purchase of vehicles, (ii) salaries of civil servants, (iii) any foreign travel, (iv) scholarships or long internships, (v) detailed engineering design, (vi) civil works and other related expenses, and (vii) items on the ADB List of Ineligible Items (or Negative List) and Prohibited Investment Activities List.¹²

16. The implementing agencies will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, secretarial assistance, and other in-kind contributions.

D. Implementation Arrangements

17. The executing agency for this JFPR TA is the Ministry of Plantation. The implementing agencies are the Ministry of Finance's Department of Development Finance, the Tea Small Holdings Development Authority, Sri Lanka Tea Board, and the Ministry of Plantation. The Tea Research Institute will also provide necessary inputs to the applicable implementing agencies. ADB will administer the JFPR TA and recruit consultants to support the project implementation. It will carry out the procurement of goods and services associated with TA activities, such as the procurement of software for the mobile application, in accordance with the ADB Procurement Policy (2017, as amended from time to time).

18. The implementation arrangements are summarized in the table.

Implementation Arrangements			
Aspects	Arrangements		
Indicative implementation period	November 2020–March 2024		
Executing agency	MPI		
Implementing agencies	(i) MOF DDF for TA outputs 1 and 4 (ii) TSHDA for TA output 1 (iii) SLTB for TA output 2 (iv) MPI for TA outputs 3 and 4		
Consultants	To be selected and engaged by ADB		
	Individual 1: individual selection	Safeguards—SMEs: national expertise (12 person-months); time-based contract	\$25,000
	Individual 2: individual selection	Project management—SMEs: national expertise (24 person-months); time-based contract	\$75,000
	Individual 3: Individual selection	Smart agriculture and policy adviser—tea: national expertise (6 person-months)	\$45,000
	Firm 1: CQS	Finance—tea: national expertise (48 person-months); output-based contract	\$200,000
	Firm 2: QCBS	Smart agriculture and policy—tea: international expertise (4 person-	\$435,000

¹² ADB. 2005. [Cost Sharing and Expenditure Eligibility of Expenditures for Asian Development Bank Financing: A New Approach. Innovation and Efficiency Initiative](#). Manila.

Aspects	Arrangements		
		months) and national expertise (62 person-months)	
	Firm 3: QCBS	Information technology (service provider): national expertise (120 person-months); output-based contract	\$360,000
	Firm 4: CQS	Impact evaluation: international expertise (4 person-months) and national expertise (8 person-months); output-based contract	\$160,000
Advance contracting	Advance contracting will be undertaken for firm 1.		
Disbursement	The TA resources will be disbursed following ADB's <i>Technical Assistance Disbursement Handbook</i> (2010, as amended from time to time).		
Asset turnover or disposal arrangement upon TA completion	The ownership of the mobile platform will be transferred to the government after TA completion.		

ADB = Asian Development Bank, CQS = consultants' qualifications selection, MOF DDF = Ministry of Finance's Department of Development Finance, MPI = Ministry of Plantation, QCBS = quality- and cost-based selection, SLTB = Sri Lanka Tea Board, SMEs = small and medium-sized enterprises, TA = technical assistance, TSHDA = Tea Small Holdings Development Authority.

Source: Asian Development Bank.

19. **Consulting services.** ADB will engage the consultants and its associated project administration instructions and/or staff instructions.¹³

20. **ADB's procurement.** Procurement will follow the ADB Procurement Policy and the Procurement Regulations for ADB Borrowers (2017, as amended from time to time).

21. **Social media and websites.** Social media and websites developed for the mobile application service will be transferred to the government after TA completion.

22. **Cofinancier requirements.** ADB will administer the TA in compliance with the JFPR Policy Guidelines for Technical Assistance Grants.¹⁴

¹³ Terms of Reference for Consultants (accessible from the list of linked documents in Appendix 2 of the report and recommendation of the President).

¹⁴ ADB. 2020. [Japan Fund for Poverty Reduction Policy Guidelines for Technical Assistance Grant](#). Manila.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Amount
Japan Fund for Poverty Reduction^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants	100.0
ii. National consultants	1,200.0
b. Out-of-pocket expenditures	
i. International and local travel	60.0
ii. Surveys ^b	80.0
iii. Training and conference ^c	80.0
iv. Miscellaneous administration and support costs ^d	80.0
v. Reports and communications	10.0
2. Pilot testing ^e	40.0
3. Contingencies	100.0
Total	1,750.0

Note: The technical assistance (TA) is estimated to cost \$1,800,000, of which contributions from the Japan Fund for Poverty Reduction are presented in the table above. The government will provide counterpart support in the form of counterpart staff, office accommodation, office supplies, secretarial assistance, and other in-kind contributions. The value of government contribution is estimated to account for 2.8% of the total TA cost.

^a Administered by the Asian Development Bank.

^b The survey cost budget includes rigorous impact evaluation of a new mobile application on tea smallholders' productivity.

^c Training and conference costs include (i) \$50,000 for financial literacy training for at least 1,500 tea smallholders, (ii) \$20,000 for mobile application trainings in four districts, and (iii) \$10,000 for a seminar on smart tea agriculture in Sri Lanka.

^d Miscellaneous administration and support costs include the service development and marketing campaign of a new mobile application through tea factories and lead farmers in four districts.

^e Seed funding includes a partially subsidized fee for the new mobile application service for tea smallholders.

Source: Asian Development Bank estimates.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/LinkedDocs/?id=49273-004-TARreport>

1. Terms of Reference for Consultants