

ASIAN DEVELOPMENT BANK

TAR: BHU 37166

TECHNICAL ASSISTANCE
(Financed by the Government of Denmark)

TO THE

KINGDOM OF BHUTAN

FOR

SMALL AND MEDIUM ENTERPRISE DEVELOPMENT

October 2004

CURRENCY EQUIVALENTS

(as of 30 September 2004)

Currency Unit	–	ngultrum (Nu)
Nu1.00	=	\$0.02163
\$1.00	=	Nu46.23

ABBREVIATIONS

ADB	–	Asian Development Bank
BDS	–	business development service
CEC	–	comprehensive entrepreneurship course
CPM	–	Country Programming Mission
GDP	–	gross domestic product
GTZ	–	Deutsche Gesellschaft für Technische Zusammenarbeit
MTI	–	Ministry of Trade and Industry
NIE	–	newly industrialized economy
PTL	–	project team leader
SME	–	small and medium enterprise
9FYP	–	Ninth Five-Year Plan

TA CLASSIFICATION

Poverty Classification	Other
Sector	– Finance
Subsector	– Finance sector development and reforms
Themes	– Sustainable economic growth, governance, and Private sector development
Subthemes	– Financial and economic governance, Catalyzing private sector investment, and Policy/institutional/legal/regulatory reforms

NOTE

In this report, "\$" refers to US dollars.

This report was prepared by V.V. Subramanian.

I. INTRODUCTION

1. During the Country Programming Mission (CPM) of the Asian Development Bank (ADB) in April 2003, the Government of Bhutan (Government) requested a technical assistance (TA) grant to help Government prepare a comprehensive sector assessment, identify the key constraints on small and medium enterprise (SME) development, and formulate a program for the effective promotion of SMEs to foster private sector development, generate employment, and reduce poverty. This TA is in line with the financial sector development program for Bhutan, as agreed upon by the CPM and the Government. An advisory TA is included in the Bhutan Country Strategy and Program Update for 2004–2006. A Fact-Finding Mission¹ visited Bhutan in March 2004 and reached an understanding with the Government on the objectives, scope, cost estimates, financing plan, and implementation arrangements for the TA. The TA framework is in Appendix 1.²

II. ISSUES

2. Bhutan's Ninth Five-Year Plan 2002–2007 (9FYP) anticipates annual gross domestic product (GDP) growth rates of 7–9%. To achieve these growth targets, the 9FYP emphasizes strengthening infrastructure, improving the quality of social services, ensuring good governance, promoting private sector growth and employment generation, and preserving Bhutan's culture and environment. The task of absorbing an estimated labor force of 70,000 that will enter the labor market during the 9FYP is challenging and adds urgency to the promotion of private sector activity. Implementation of planned financial sector reform and a parallel thrust on SME development will result in increased competition and productivity. Given the growing concerns over the expanding labor force, government policies have started to put more emphasis on private sector development and financial sector reforms.

3. As public sector employment opportunities will be limited, the private sector, particularly SMEs, is expected to play a greater role in absorbing the growing number of young and educated Bhutanese. Despite recent efforts, however, the Government still has limited capacity to effectively formulate and implement policies for SME promotion. Although Bhutan demonstrated strong economic performance in recent years, continued improvements in the financial system will be necessary to support the country's further development. Much of Bhutan's economic growth and financial sector development has been driven by the public sector, as reflected in the high rates of growth in hydropower and savings of government corporations. Growth in the private sector remains slow since savings mobilization is low and viable investment projects are limited.

4. Prior to the opening of the economy in the 1950s, the only private sector activity was in agriculture supplemented by some trading activities. Since then, the economy has seen transformation with rapid growth in urban centers, establishment of basic infrastructure services, and development of an important hydropower sector. Reflecting the nascent stage of the private sector, Bhutan's economy is dominated by cottage and micro industries that comprise about 85% of the country's total establishments. As of December 2001, Bhutan has about 409 small-scale and 43 medium-scale enterprises in industry, production, and manufacturing. The country also has about 878 cottage and 2,435 mini enterprises. The major challenge for the Government is to increase the activity of the private sector, which now contributes less than 25% of Bhutan's GDP.

¹ Comprising V.V. Subramanian, Financial/Capital Markets Specialist, and Y. Elhan-Kayalar, Economist, SAGF.

² The TA first appeared in *ADB Business Opportunities* (Internet edition) on 13 May 2004.

5. Small and micro industries must be developed to enhance Bhutan's rural income and employment. The 9FYP aims to focus on a legislative framework for industrial development, including formulation and enactment of legislation for industrial policy, transfer of technology, and foreign direct investment, apart from initiatives for developing the capital market. The main thrust for the industry sector during the 9FYP will be to create industrial estates around the country to facilitate the development of the SME sector.

6. The development of the SME sector is thus all the more critical for overall development of the economy (Appendix 2). Though there is no precise definition of SMEs in Bhutan, investments of above Nu100 million are currently classified as large, while investments up to Nu100 million are categorized as micro or cottage, small or medium, based on the invested capital. Though the Government, through the Ministry of Trade and Industry (MTI) and Ministry of Agriculture, has taken a number of initiatives, the impact has so far been negligible. Given the importance of the SME sector in the economy of Bhutan and understanding the constraints under which the sector operates, it is evident that policies and an institutional framework to support the development and growth of SMEs are necessary. A more concerted and holistic approach is needed to address the various factors impeding the growth of the sector. Market development is a much more challenging task, which requires coordinated efforts by individual enterprises, the chambers of commerce, and the Government.

7. The Department of Industry is entrusted with the responsibility to foster sustainable industrial development in harmony with national objectives and priorities. Accordingly, its functions are promotional as well as regulatory, by nature covering the industry sector classified broadly under manufacturing and services. At present, the sector operates under the *General Guidelines for Industrial and Commercial Ventures in Bhutan* (1997). However, the country does not have an established legal framework or supporting rules and regulations for the sector. A draft business licensing act has been prepared but is yet to be enacted into law. Under the provisions of the proposed act, MTI will consolidate and frame rules and regulations for business activities in Bhutan. The Foreign Direct Investment Policy was approved by the Council of Ministers on 3 December 2002 and the executive order to treat the policy as regulations until it is enacted was issued on the same date. Rules and regulations to operationalize the policy have already been drafted.

8. SMEs in Bhutan face a number of constraints to growth: (i) lack of entrepreneurial talent, (ii) lack of basic skills, (iii) lack of modern technology, (iv) lack of capital, (v) restricted access to financing, (vi) absence of clear-cut government policies for the SME sector, (vii) lack of research and development facilities, (viii) poor physical infrastructure and high transportation costs, and (ix) poor information about market opportunities and requirements. Therefore, systematic and in-depth studies are needed to clearly identify the operational constraints of the different sector categories. At the micro level, institutional support will be required to assist SMEs to link with commercial sources of funds, acquire better marketing information, especially about domestic and export markets, and strengthen their abilities to prepare business plans. The focus, however, should be on promoting markets, and market-based provision of finance and support services, with the public sector providing key interventions by setting policy and monitoring performance.

9. Bhutan's exports are mostly to India under the free trade agreement, with about 4% to Bangladesh under the preferred trade agreement. With India's accreditation to the World Trade Organization, Bhutan's exports are no longer competitive. Not only does Bhutan need to improve its competitive strength; it must also look to markets beyond India and Bangladesh. There is an urgent need to make SMEs internationally competitive by providing them with

supporting services such as quality control, facilitating networking and clustering, commercializing research and development through technology incubators, providing appropriate incentives, and promoting regional cooperation by encouraging the networking of SME support agencies.

10. Bilateral assistance for Bhutan in SME development has been forthcoming in a limited way—from *Stichting Nederlandse Vrijwilligers* (SNV), *Deutsche Gesellschaft für Technische Zusammenarbeit* (GTZ), and United Nations Development Programme—and focused in the areas of training in basic skills and developing business development services centers. Despite recent efforts by the Government and external agencies, a framework for SME promotion is still incomplete, in terms of both policy and institutions. Since MTI is not yet adequately staffed, the Government has been unable to effectively formulate and implement policies for SME promotion. Therefore interventions need to be complemented by a more focused and targeted approach for the overall SME sector. The Entrepreneur Development Program (EDP) loan scheme was launched in 1992 with capital funds of Nu100 million set aside by four financial institutions and was intended to address the financing needs of individuals who successfully completed the comprehensive entrepreneurship course (CEC), conducted by Entrepreneurship Promotion Center-MTI. Of the 193 persons trained under the CEC program, only 47 could avail themselves of financial assistance until 2003. Of that 47, only 14 are operating satisfactorily, six are facing operational problems, and the rest have either closed or are facing litigation. Though performance under the scheme has been rather disparate, the EDP loan scheme was a step in the right direction. However, the program has not received much interest as the financing conditions were too restrictive. In addition, the Government established in 2003 a credit guarantee scheme to improve the flow of finance from the two commercial banks where loans up to a maximum of Nu200,000 will be guaranteed to the extent of 60% by the Government. Under the ADB-assisted Basic Skills Development Project,³ the Government established five vocational training institutes to provide training in 13 basic craft and arts skills. However, getting qualified trainers has been a constraint. This facility has been supplemented by a parallel assistance of \$2.5 million from GTZ.

11. Nevertheless, Bhutan's SME sector continues to face challenges that relate to the nascent stage of the private sector in the Bhutanese economy. Despite recent efforts by the Government and external agencies, a framework for SME promotion is still incomplete, in terms of both policy and institutions. The Government has limited capacity to effectively formulate and implement policies for SME promotion. The overall framework is essential for SME development that encompasses other constraints and issues that have been enumerated. In addition, close coordination among funding agencies is important to address the issues surrounding SMEs. The TA will seek active coordination and ensure complementarities between the initiatives of other institutions and those of ADB.

12. The Labor Law, drafted with the assistance of an ADB-funded TA, is yet to be enacted into law. Assistance will be required to develop rules and regulations once the law is enacted. It is expected that 80% of the labor force currently in the SME sector will be covered by the proposed Labor Law. The Business Licensing and Registration System also needs to be streamlined with laid-down procedures and guidelines. Though the Cooperatives Act was enacted in 2002, it is not yet operational as the rules and regulations are still to be framed.

³ ADB. 2001. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to Bhutan for Basic Skills Development Project*. Manila (\$6.92 million).

13. To support the development and growth of the SME sector in Bhutan, three targeted actions should be pursued: (i) formulate and implement an SME policy, (ii) create an enabling environment for SMEs, and (iii) promote the growth of targeted business support services. For this purpose, diagnostic studies of the SME sector are required to identify what further policy and institutional support need to be established to develop the sector. The provision of business support services also needs to be examined for sustainability through either the private or public sector. Key support services include skills training, trade fairs, appropriate technology know-how, marketing linkages, and business support services. In addition, existing institutional mechanisms and financing modalities for SMEs need to be examined to improve financial services for the SME sector. The examination may build on the private sector survey conducted under a World Bank study in 2002.

14. Regional cooperation is a key issue for the development of a landlocked country like Bhutan. ADB projects (such as the proposed dry port development, and road network) have regional cooperation as one of their thematic areas. As a member of the South Asia Association for Regional Cooperation (SAARC), Bhutan signed the South Asia Free Trade Agreement in January 2004 and committed itself to bring down customs tariffs during the next 10 years after the agreement comes into force. In February 2004, Bhutan became a member of BIMST-EC.⁴ The aim of the group is to foster socioeconomic cooperation among the member countries.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

15. The TA will help formulate a focused and sustainable framework for SME promotion, consistent with the broad vision of the Government on SME development. The output of the TA will include a full sector assessment, identifying the key constraints on SME development; a diagnostic analysis and time-bound action plan tailored to Bhutan; and a comprehensive framework and strategy for SME promotion including business development services and enhancing SME access to credit for the medium and long-term. After an in-depth analysis of the issues, a road map will be developed that will provide the policy, legal, regulatory, and institutional framework for the SME sector. The overall framework will involve (i) completing a policy and institutional framework for SME promotion including improving market and other related information provision to SMEs; (ii) strengthening the system for capacity building for SMEs, including technical centers for enhancing the current industrial and technical standards and information on technology transfer and access to market information for SMEs; and (iii) improving the bankability of SME projects and SME access to the financial system through better practices, methodologies, and instruments.

B. Methodology and Key Activities

16. The TA will initially undertake an in-depth diagnostic study of the SME sector, particularly, existing interventions; identify the key constraints and from the findings, decide what further policy and institutional support need to be established for developing the sector. A series of studies will be prepared for this purpose, built on existing studies and supplemented, where necessary, by additional analyses, interviews, and surveys of SMEs, and in close consultation with the Government, nongovernmental organizations (NGOs), and representatives of funding agencies and the business sector. The findings will help provide the necessary

⁴ Bangladesh, Bhutan, India, Myanmar, Sri Lanka, Thailand, Nepal Economic Cooperation.

underpinning for further strategies and actions and assist in developing an integrated strategy for promoting SME business in Bhutan. The data will indicate how business support services are to be provided on an ongoing sustainable basis—through either the private or public sector. In addition, appropriate policy and incentives will be identified for improving the bankability of SME projects and existing institutional mechanisms and financing modalities for SMEs will be examined to improve aspects of financial services for the SME sector.

17. The TA will further provide for a 2-week overseas study tour of selected officials from MTI, Ministry of Labor, and Ministry of Law to a couple of the newly industrialized economies to study and understand the policy initiatives taken and support services provided in developing SME sector. As the TA will require close consultation with stakeholders, workshops will be organized and other opportunities will be available to build consensus on the outputs of the TA.

C. Cost and Financing

18. The TA is estimated to cost \$375,000 equivalent, comprising \$279,000 in foreign exchange and \$96,000 equivalent in local currency. The TA will finance the entire foreign exchange cost and \$21,000 equivalent of the local currency cost on a grant basis. The TA will be financed as a grant by the Government of Denmark and administered by ADB. The Government will finance the remaining \$75,000 equivalent of the local costs, including provision of counterpart staff, office space, administrative services, and physical facilities. The cost estimate and the financing plan are in Appendix 3.

D. Implementation Arrangements

19. The MTI will be the Executing Agency for the TA. To facilitate TA implementation, a working committee will be established headed by the secretary of MTI, with representatives from the ministries of labor as well as law. The TA will be implemented over 4 months from January to April 2005 and will require four international consultants (9 person-months total) and one domestic consultant (3 person-months). The consultants will submit to MTI, the Government, and ADB an inception report 2 weeks after the work starts. An interim report based on the diagnostic analysis will be submitted 6 weeks after the start of the TA and will be discussed at a tripartite meeting of the Royal Monetary Authority, Government, and ADB. The draft final report with the detailed framework for SME development will be submitted 2 weeks before the completion of the project and will be discussed at a tripartite meeting of the principals of the TA. The final report will be submitted after incorporating comments at the end of the consulting period. The international consultants will be an SME sector development or business specialist, as project team leader; SME legal and regulatory specialist; SME finance specialist; and an SME business development services specialist. The domestic consultant will be an industry specialist. An international consulting firm will be recruited, using simplified technical proposals under the quality- and cost-based selection method, in accordance with ADB's *Guidelines for the Recruitment of Consultants* and other arrangements satisfactory to ADB for selecting domestic consultants. The outline terms of reference for the consultants are in Appendix 4.

IV. THE PRESIDENT'S DECISION

20. The President, acting under the authority delegated by the Board, has approved ADB administering technical assistance not exceeding the equivalent of \$300,000 to the Government of Bhutan to be financed on a grant basis by the Government of Denmark for Small and Medium Enterprise Development, and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Goal</p> <p>Development of Bhutan's small and medium enterprise (SME) sector resulting in improved economic growth, employment, and poverty reduction</p>	<p>Increased SME activities and their contribution to economic growth</p>	<p>Government statistical reports</p> <p>Technical assistance (TA) steering committee meetings</p> <p>TA review meetings</p> <p>Ministry of Trade and Industry (MTI) report and publications</p>	
<p>Purpose</p> <p>Formulate a focused and sustainable framework for SME promotion</p>	<p>Comprehensive framework and strategy for SME promotion developed including business services and enhanced SME access to credit for the medium and long- term</p>	<p>Feedback from stakeholders and consensus on reform design</p> <p>Consultants' reports</p> <p>Tripartite meetings</p> <p>Asian Development Bank (ADB) review missions</p>	<p>Continued focus and thrust on SME development and poverty reduction by all stakeholders and in ADB country strategy and program</p> <p>Government concurrence on recommended action plans</p> <p>Coordination among all concerned agencies</p> <p>Lending institution commitment and support</p>
<p>Outputs</p> <p>Full sector assessment identifying the key constraints in SME development, a diagnostic analysis and time-bound action plan tailored to Bhutan developed</p> <p>Cost and risks related to SME financing reduced</p> <p>Bankability of SME projects improved</p>	<p>Issues and constraints to SME development identified within 6 weeks after the TA begins, including sectoral issues for policy formulation</p> <p>Strategies and actions to address bottlenecks in SME development decided within 12 weeks after the TA begins</p> <p>Integrated policy, legal, regulatory, and institutional framework developed together with appropriate incentives for overall development of the</p>	<p>Consultants' reports</p> <p>Tripartite meetings</p> <p>MTI reports and feedback</p> <p>ADB review missions</p> <p>Consultants' reports</p> <p>Tripartite meetings</p> <p>MTI reports and feedback</p> <p>ADB review missions</p> <p>Consultants' reports</p> <p>Tripartite meetings</p> <p>MTI reports and feedback</p>	<p>Government support and commitment to reform</p> <p>Commitment to implement recommended action plans</p> <p>Coordination with agencies and financial intermediaries</p> <p>Government support and commitment</p> <p>Stakeholder participation</p>

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Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
Need for complementary business support services assessed Workshops	SME sector within 2 weeks from TA completion.	ADB review missions	

Activities			
(i) Diagnostic analysis of the SME sector (including sectoral issues for policy formulation) conducted			
(ii) Past performance of SME sector reviewed in respect of capital investment, employment generation, value of products or exports and value addition, and any other performance features; constraints encountered by the sector identified; and prospects for its future development evaluated			
(iii) Constraints that have hindered the development of the SME sector—with reference to the availability of technical services, seed capital, access to credit, infrastructure facilities, consulting services, marketing facilities, quality control, and support services—identified and assessed whether an integrated approach to future development of SMEs is feasible			
(iv) Based on the diagnostic study, formulation of action plans to address the identified issues, in particular, improving the legal and regulatory environment for SMEs by streamlining and modifying regulations, licensing and registration requirements, and possible elimination of unnecessary procedures			
(v) Nonfinancial institutional support and services that are needed by the SME sector evaluated			
(vi) Action plans for establishing centers for market and linkage to foreign firms developed in terms of overall development impact, and long-term financial sustainability			
(vii) Impediments to SMEs' access to credit identified			
(viii) SME sector development and financing plans formulated relating to the integrated development of SMEs, financial investment in SMEs, human resources development, marketing, infrastructure, consultancy, technical extension, and other support services			
(ix) Discussions and workshops with stakeholders conducted to build consensus on the SME framework			
(x) Overseas study tour, preferably up to two countries, designed and organized for key policy makers			
(xi) Scope of further assistance that may be needed to implement the proposed SME sector development and financing plans formulated			
Inputs			
9 person-months of international consulting services	\$207,000	Consultants' reports	Qualified consultants fielded on time
3 person-months of domestic consulting services	\$11,000	ADB review missions	
Travel and other costs	\$82,000	Tripartite meetings	
Counterpart support	\$75,000		
Total Cost	\$375,000		

INITIAL POVERTY AND SOCIAL ANALYSIS

A. Linkages to the Country Poverty Analysis

Is the sector identified as a national priority in country poverty analysis?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No	Is the sector identified as a national priority in country poverty partnership agreement?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
<p>Contribution of the sector or subsector to reduce poverty in Bhutan</p> <p>The development of small and medium enterprises (SMEs) has significant implications for poverty reduction. SMEs will enhance the current economic structure, income, and employment-generating activities; reduce income fluctuation of individuals and businesses and thus contribute to macroeconomic stability and poverty reduction.</p> <p>SMEs are the prime drivers of new employment. The task of absorbing a labor force of 70,000 expected to enter the labor market in Bhutan during the Ninth Five-Year Plan 2002-2007 (9FYP) is challenging and adds urgency to the promotion of private sector activity. Implementation of planned financial sector reform and a parallel thrust on SME development will result in increased competition and productivity. Given the growing concerns over the expanding labor force, government policies have started to put more emphasis on private sector development and financial sector reforms.</p> <p>As public sector employment opportunities will be limited, the private sector, particularly SMEs, is expected to play a greater role in absorbing the growing number of young and educated in Bhutan. Given its high multiplier effect on the national economy, the SME sector is critical for financing and policy intervention to support the growth rate of the economy. The Project will support the Government's recognition of the significant role SMEs can play in achieving national development goals and its efforts to realize the 9FYP objectives of annual gross domestic product (GDP) growth rates of 7-9%. The major challenge for the Government is to increase activity of the private sector, which now contributes less than 25% of Bhutan's GDP.</p>			

B. Poverty Analysis

Proposed Poverty Classification

<p>What type of poverty analysis is needed?</p> <p>SMEs enhance competition and entrepreneurship and hence have external benefits on economy-wide efficiency, innovation, and aggregate productivity growth. They will help exploit the social benefits from greater competition and entrepreneurship, will lead to more productivity, and boost employment more than large firms as SMEs are more labor intensive. The government has rightly recognized the tremendous role the SME sector can play in terms of job creation and labor mobility.</p> <p>SMEs are therefore vital for the country to absorb the labor force of 70,000 expected during the 9FYP, and to stimulate employment intensive growth in rural areas, moving workers out of agriculture. Private sector SMEs are likely to be the main source of investment opportunities that generate economic growth and create employment. The social and poverty impact will be appropriately analyzed while recommending the policy and reform framework for the SME sector.</p>	
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C. Participation Process

Is there a stakeholder analysis?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	
<p>Social assessment will have the participation of the following main stakeholders: SME entrepreneurs, the two commercial banks, Ministry of Trade and Industry and Ministry of Labor, other related government agencies, nongovernment organizations, and selected bilateral agencies.</p>			
Is there a participation strategy?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No	
<p>The key aim of the Project is to support the Government's recognition of the significant role SMEs can play in achieving national development goals and its efforts to realize the 9FYP objectives. Therefore, the emphasis of social assessment will be on a participatory process aimed at SME sector development. The assessment will ensure the</p>			

participation of various stakeholders through such methods as participatory stakeholder interviews, focus group discussions, and participatory rapid appraisal.

D. Gender Development

Strategy to maximize impacts on women:

One among the many priorities will be improving knowledge about female entrepreneurship and its role in the economy and society, improving knowledge about financing of women-owned businesses and removing obstacles in this area, fostering the development and growth of women-owned businesses, and fostering an entrepreneurial culture through improved education management training for women and girls. The Project will directly assist in strengthening the institutional structure for SME lending and help improve the bankability of such projects through policy reforms and other enabling conditions .

Has an output been prepared? Yes No

E. Social Safeguards and other Social Risks

Item	Significant/ Not Significant/ None	Strategy to Address Issues	Plan Required
Resettlement	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	No resettlement issues with result from the implementation of the project.	<input type="checkbox"/> Full <input type="checkbox"/> Short <input checked="" type="checkbox"/> None
Affordability	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	There will be no affordability-related issues. In contrast, credit delivery at competitive rates along with productivity improvements will result in a more competitive SME sector.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Labor	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	A positive labor impact is expected as a result of extended credit outreach and expanded economic opportunities in urban and rural areas.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Indigenous Peoples	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	No issues of indigenous peoples are involved.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
Other Risks and/or Vulnerabilities	<input type="checkbox"/> Significant <input type="checkbox"/> Not significant <input checked="" type="checkbox"/> None	No other adverse issues are anticipated.	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No

COST ESTIMATES AND FINANCING PLAN
(\$ '000)

Item	Foreign Exchange	Local Currency	Total Cost
A. Government of Denmark Financing^a			
1. Consultants			
a. Remuneration and Per Diem	207.0	11.0	218.0
b. International Travel	20.0	0.0	20.0
c. Communications	2.0	0.0	2.0
2. Study Tour	25.0	0.0	25.0
3. Workshops	0.0	5.0	5.0
4. Contingency	25.0	5.0	30.0
Subtotal (A)	279.0	21.0	300.0
B. Government of Bhutan Financing			
1. Office, Secretarial, and Related Services	0.0	35.0	35.0
2. Local Counterpart	0.0	15.0	15.0
3. Local Transport	0.0	10.0	10.0
4. Contingency	0.0	15.0	15.0
Subtotal (B)	0.0	75.0	75.0
Total	279.0	96.0	375.0

^a Administered by the Asian Development Bank.
Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. The team of international and domestic experts (with person-months in parentheses) will include a small and medium enterprise (SME) sector development or business specialist, as project team leader (PTL) (international, 4), SME legal and regulatory specialist (international, 1), SME finance specialist (international, 2), and SME business development services (BDS) specialist (international, 2). The domestic consultant will be an industry specialist (3).

A. Small and Medium Enterprise Sector Development or Business Specialist and Team Leader (international, 4 person-months)

2. The PTL will have an extensive working knowledge of SME development, its policy and institutional framework, and applicable international best practices. The PTL will be responsible for all outputs from the technical assistance (TA) and will coordinate and guide the other consultants under the project.

3. The PTL's tasks and responsibilities will include the following:

- (i) Coordinate with other consultants in drafting a medium- and long-term SME development plan. Develop a framework for SME development policies as well as institutional and legal reforms, based on an in-depth analysis of the SME sector, including sectoral issues for policy formulation. (The analysis should include (a) a profile of SMEs, (b) identifying binding constraints, and (c) a profile of externally funded activities.) In the process review and assess the results of the Government policy measures undertaken to help develop and fund SMEs.
- (ii) Describe the SME sector in terms of geographical distribution and size; review its past performance in the country's economy in respect of capital investment, employment generation, value of products or exports and value addition, and any other performance features; describe the constraints encountered by the sector; and evaluate the prospects for its future development.
- (iii) Identify the constraints that have hindered the development of the SME sector with reference to the availability of technical services and seed capital, access to credit, business climate, infrastructure facilities, consulting services, marketing facilities, quality control, and support services. Interact with the Government and assess whether an integrated approach is feasible for the future development of SMEs.
- (iv) Based on the above findings, coordinate with the legal and regulatory specialist in preparing an action plan for improving the legal and regulatory environment for SMEs by recommending streamlining and modifying regulations, licensing and registration requirements, and possibly eliminating unnecessary procedures.
- (v) Based on the findings of the diagnostic study, coordinate with the BDS specialist in evaluating what market-based services are needed by the SME sector to enable it to become an effective participant in a market-based economy. In the evaluation, consider human resources development, appropriate technology, marketing and quality control, consulting services, and investment appraisal, and incorporate the results of studies undertaken under other external assistance.
- (vi) Coordinate with the SME finance specialist to study the financial and investment components and help enhance SME access to credit.

- (vii) On the basis of the (i) to (vi), formulate a comprehensive framework and strategy for SME promotion including business development services and enhanced SME access to credit in the medium and long- term. Include a road map that addresses the identified constraints. Make plans that are market driven and relate to the integrated development of SMEs, financial investment in SMEs, human resources development, marketing, infrastructure, consultancy, technical extension, and other support services.
- (viii) Conduct discussions and workshops with stakeholders to build consensus on the SME framework.
- (ix) Prepare a directory of SMEs.
- (x) Formulate the scope of further assistance that may be needed to implement the proposed SME sector development and financing plans.
- (xi) Design and arrange an overseas study tour—preferably up to two countries— to provide key policy makers with practical knowledge and experience on how policy initiatives have been taken and support services provided to develop the SME sector.
- (xii) Avoid duplication of work in regard to various microcredits and micro enterprise programs or projects currently being carried out by the Government with the assistance of multilateral or bilateral organizations.

B. Small and Medium Enterprise Legal and Regulatory Specialist (international, 1 person-month)

4. The specialist will have an extensive working knowledge of developing an SME policy framework and relevant international best practices relating to the regulations and procedures for the SME sector. The specialist will work closely with the PTL and share responsibilities as needed. The specific responsibilities will include the following:

- (i) Review studies on the business climate, existing legislation, regulations and procedures, including the secured transactions system and related legal requirements for the establishing, registering, licensing, and operating SMEs.
- (ii) Identify key regulations at the central and local levels that hinder SME development.
- (iii) Prepare an action plan for improving the legal and regulatory environment for SMEs by recommending streamlining or modifying regulations, licensing and registration requirements, and possibly eliminating unnecessary procedures.
- (iv) Help the PTL draft the SME development framework in respect of policies, institutional and legal reforms (including SME laws, subdecrees, registration and licensing reform plans) based on the in-depth analysis of the existing environment for SMEs.
- (v) Help the PTL conduct discussions and workshops with stakeholders to build consensus on the framework.

C. Small and Medium Enterprise Finance Specialist (international, 2 person-months)

5. The specialist will have extensive knowledge of financing the SME sector and developing risk-mitigating products for SME financing. The specific responsibilities will include the following:

- (i) Examine constraints to and scope of lending to SMEs and make recommendations, as appropriate, to enhance financial institutions' capabilities to serve the sector in a sustainable manner.
- (ii) Evaluate the experience of and prospects for channeling funds to SMEs through existing financial intermediaries.
- (iii) Study and propose a financing model and system that will enhance SMEs access to credit.
- (iv) Identify products for mitigating lending risks to the SME sector.
- (v) Help the PTL draft the framework, especially covering the financial and investment components, including inputs on policy measures to enhance SMEs' access to financial resources.
- (vi) Coordinate with the PTL to conduct discussion and workshops with the relevant stakeholders and financial institutions to build consensus on the SME framework.

D. Small and Medium Enterprise Business Development Services Specialist (international, 2 person-months)

6. The specialist will have extensive knowledge in providing sustainable business development support services for the SME sector and improving the bankability of SME projects. The specific responsibilities will include the following:

- (i) Based on experience in similar countries, assess the need for SME business support services for various types of SMEs, evaluate the effectiveness of these programs in meeting these needs, and recommend improvement wherever necessary.
- (ii) Assess the potential for cost sharing for different types of services.
- (iii) Examine the scope of commercial delivery of such services by the private sector.
- (iv) Assess the need and scope for coordinating different SME support services and recommend an appropriate institutional framework for providing a Government support program. In the process, take into account all existing services and training programs offered to SMEs and analyze the scope for potential integration of the services with other services identified under the TA.
- (v) While developing the institutional framework for establishing business support services, design programs to enhance SMEs' capacity-building, technology transfer, and market linkage efforts.
- (vi) Include advisory services in the areas of accounting, business plan and marketing plan development, etc.

- (vii) Help the Government establish principles for monitoring and evaluating SME support programs and support services in terms of whether they are best divested to the private sector, provided on a cost-recovery basis (partial or otherwise), etc.

E. Industry Specialist (domestic, 3 person-months)

7. The domestic consultant should have a sound knowledge of SME activities in Bhutan, current initiatives taken by the Government, and perceived impediments. The consultant will provide inputs related to the SME development framework, especially issues in formulating an SME development strategy based on the consultant's knowledge of local conditions and environment. The consultant will undertake the following tasks:

- (i) Help the PTL assimilate and analyze information on current SME activities in Bhutan.
- (ii) Assist the international consultants and provide logistic support for meetings with local agencies, financial institutions, SME entrepreneurs, and nongovernment organizations for meetings.
- (iii) Arrange and organize discussions and workshops, and help the PTL in the process.