Validation Report

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Bhutan: Micro, Small, and Medium-Sized Enterprise Sector Development Program

Independent Evaluation Department
Asian Development Bank
ABBREVIATIONS

ADB – Asian Development Bank
BDBL – Bhutan Development Bank Limited
BDFC – Bhutan Development Finance Corporation
BDS – business development services
BSB – Bhutan Standard Bureau
CSF – cost-sharing facility
DCSI – Department of Cottage and Small Industry
DMF – design and monitoring framework
GDP – gross domestic product
MEA – Ministry of Economic Affairs
MSME – micro, small, and medium enterprise
SDP – sector development program
PCR – program completion report
PPMU – Program and Project Management Unit
RIA – regulatory impact assessment
RMA – Royal Monetary Authority
RRP – report and recommendation of the President

NOTE

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

Key Words

asian development bank; bhutan development bank limited; business development services; business license; cost-sharing facility; micro, small, and medium-sized enterprises; royal monetary authority.

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I. PROJECT DESCRIPTION

A. Rationale

1. During the project preparation stage, the economic growth of Bhutan depended heavily on the hydropower industry and related subsectors, which had limited employment opportunities. Another important sector was agriculture, which had over 40% of the total labor force. However, development in this sector was on the decline. Given the increasing number of youths entering the labor market and the influx of people to the urban areas, the government had to quickly address the narrow economic base to generate employment and fuel further growth and development, especially in the rural areas. As such, the development of the private sector was considered to be critical for the achievement of a sustainable, broad-based economic growth.
2. The private sector in Bhutan was comprised mainly of micro, small, and medium enterprises (MSMEs).\(^1\) However, the MSME sector remained weak and had yet to generate employment opportunities. Its development had been constrained by (i) lack of a suitable development policy and supporting institutional framework; (ii) lack of enabling environment for business to operate, such as inadequate laws and regulations; (iii) limited access to finance; (iv) limited business infrastructure, such as business development services (BDS); and (v) lack of legal and organizational frameworks for standards and quality control. The Micro, Small, and Medium-Sized Enterprise Sector Development Program (MSME SDP)\(^2\) was designed to address these constraints and to complement the government’s promotion of MSME development, in which the private sector was envisaged to play a vital role as the engine of growth.

B. Expected Impact

3. The program’s envisaged impact was a vibrant and expanding MSME sector that could lead to accelerated private sector development for broad-based, sustainable economic growth. The impact indicators were (i) increase in private sector contribution to gross domestic product (GDP); (ii) total employment—by private and MSME-oriented sectors (including manufacturing, trade, hotels, and services)—as a percentage of total labor force to exceed 6% by 2010; and (iii) economic growth rate of at least 7% per annum.

C. Objectives or Expected Outcome

4. The expected outcome of the program was an improved enabling environment for doing business and greater access to key resources. The outcome indicators specified in the design and monitoring framework (DMF) were (i) reduction in the number of days and procedures in setting up a new business to 30 days or less by 2010, (ii) share of the Bhutan Development Finance Corporation (BDFC) to total loan portfolio in the MSME-oriented sector to exceed 25% by 2010, and (iii) at least 250 private sector businesses assisted by the cost-sharing facility (CSF) by 2010.

D. Components and Outputs

5. The MSME SDP consisted of a program grant and a project grant. The program grant had four components: (i) establishment of policy, strategy, and institutional framework for promoting MSME development; (ii) enhancement of business laws and regulations and facilitation of business processes; (iii) increased access to market-based finance; and (iv) strengthened business support infrastructure. Key tranche conditions for the program grant were (i) the government’s adoption of an MSME policy, strategy and institutional framework, and development program; (ii) review and revision of draft legislations on enhancing business laws and regulations for submission to the National Assembly; (iii) reduction in the formal process to set up a business to less than 30 days; (iv) full operation of a CSF, and (v) approval of the plan for the establishment of product standard, testing facilities, and product certification.

6. The project grant consisted of three subprojects: (i) a credit line to the BDFC to extend credit assistance to MSMEs, (ii) a CSF to provide technical support and knowledge transfer to

\(^1\) Based on Bhutan’s official classification, micro enterprises are businesses with investments of less than Nu1 million, small enterprises have investments of between Nu1 and Nu5 million, and medium enterprises have investments of between Nu5 and Nu15 million.

growth-oriented businesses, and (iii) capacity support for program implementation and institutional capacity building to ensure sustainability of reforms under the MSME SDP.

E. Provision of Inputs

7. The cost for the policy reforms component was estimated at $17.0 million, with the Asian Development Bank (ADB) providing a program grant of $6.0 million to support the reforms. The program grant of $6.0 million was fully disbursed in three tranches. The estimated cost of the project component was $10.6 million, of which ADB provided a $9.0 million project grant to support all three subprojects. At project closing, the actual amount financed by ADB was $8.2 million, which was less than the original grant budget of $9.0 million mainly due to a shortfall in the CSF (footnote 3, para.16).

8. Consultancy services amounting to $2.0 million were provided for MSME development policy and CSF management, establishment of a central registry for movable collateral, and establishment of product standards and capacity building. The consultants were recruited in accordance with ADB Guidelines on the Use of Consultants.

F. Implementation Arrangements

9. During program implementation, the names of several agencies were changed. The Ministry of Trade and Industry was changed to Ministry of Economic Affairs (MEA), the BDFC was changed to Bhutan Development Bank Limited (BDBL), and the Standards and Quality Control Authority became the Bhutan Standard Bureau (BSB).

10. The envisaged implementation arrangements were generally followed. The Ministry of Finance was the executing agency for the MSME SDP. The MEA was the implementing agency except for two subcomponents: (i) adoption and implementation of a new 5-year business plan for the BDBL where this same bank was also the implementing agency, and (ii) improving quality standards and product certification, for which the BSB was the implementing agency.

11. The MEA established an MSME division that acted as the program and project management unit (PPMU) for MSME SDP implementation. This division was eventually upgraded and renamed the Department of Cottage and Small Industry (DCSI), which served as the PPMU for MSME SDP.

12. There were two minor changes from the implementation plan that were originally the responsibility of the MEA. First, the Government to Citizens (G2C) project, which was an initiative of the Government of Bhutan to streamline the delivery of government services to rural communities, assumed responsibility for the one-stop shops. Second, the CSF became the responsibility of BDBL. This enhanced the position of the CSF as BDBL referred its clients to the facility.

13. Consultancy services provided were generally satisfactory, except for the consultancy that prepared the strategy paper and advised on the CSF. The MEA was not satisfied with the consultancy’s first team, as the output did not adequately account for local circumstances. The consultancy team resigned, and a second team was deployed. However, the team proceeded slowly and took an academic approach with little practical applications. The MEA requested for

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a replacement of this second team. Finally, the third team performed satisfactorily as it completed the MSME Policy, Strategy, and Action Plan, which was well received by the MEA.

14. There were delays in complying with some of the covenants for the tranche release. These delays were associated with the adoption of the MSME policy, strategy, and institutional framework and the full operation of the CSF. Delays were due to consultant turnover and performance (para. 13). Thus, the second tranche was extended to resolve the delays in policy actions on the MSME policy and CSF. The plan for the central registry was also delayed, which was deferred from tranche 2 to tranche 3.

15. The program had no significant adverse impact on the environment. There were no resettlement issues encountered during program implementation.

II. EVALUATION OF PERFORMANCE AND RATINGS

A. Relevance of Design and Formulation

16. The program completion report (PCR) rated the MSME SDP relevant. It was deemed consistent with the government’s priority of promoting private sector growth and employment generation, which was one of the overall goals in Bhutan’s Ninth Five-Year Plan, 2002–2007. It was also considered in line with the ADB Country Strategy and Program for Bhutan, which identified financial and private sector development as one the areas of focus. The MSME SDP was assessed relevant in addressing the constraints to the development of the private sector and, in particular, the MSMEs (para. 2). The sector development program modality was appropriate in view of the reforms needed to develop a policy framework, a long-term vision and strategy, and a sector development program that will create an enabling environment for MSMEs. The credit line to BDBL for MSME lending and the establishment of a CSF were relevant to promoting the growth of MSMEs and in generating employment.

17. During implementation, the CSF was amended to respond to weaknesses in its original design particularly the limitation of the facility to only private providers of BDS and the cost-sharing scheme. The original design was to subsidize 50% of MSME’s costs for BDS to strengthen their capacity and improve their bankability. Initially, the CSF was limited to only private providers of BDS. However, the number of such providers was small and the training opportunities they offered were limited. Further, there was a lack of incentive for businesses to participate and pay 50% of the costs of the services as many training programs were provided by government for free. Hence, the CSF was revised to allow public providers of BDS to participate and the subsidy for MSME costs was increased to 95%. With 5 months remaining before the program’s completion, the BDBL assumed responsibility for the CSF and it subsequently enabled 1,651 people or at least 270 businesses to access the facility. The change in the CSF design was appropriate in view of the need to increase utilization and access to the CSF.

18. At program completion, the MSME SDP remained relevant to Bhutan’s unemployment problem and private sector development. In the ADB interim country strategy for Bhutan, private sector development, with continued focus on MSMEs, was one of the crosscutting themes identified. The program design with the revised CSF was adequate in addressing the constraints identified at appraisal. The changes in the CSF corrected the flaws in the original design and did not reduce the relevance of the program. The business environment for MSMEs

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improved and access to key resources, such as credit and BDS, was increased. On the whole, this validation confirms the PCR rating of relevant for the MSME SDP.

B. Effectiveness in Achieving Project Outcomes and Outputs

19. The PCR rated the MSME SDP effective in achieving the envisaged outcomes. Of the three outcome indicators specified in the DMF, two were achieved while one was partially achieved. The outcome indicator of reduction in the number of days and procedures in setting up a new business was partially achieved as the number fell from 62 days to 36 days, but still longer than the target of 30 days. On the share of total loan portfolio in the MSME-oriented sector, the MSME share of BDBL to total portfolio by 2012 reached 35%, exceeding the expected outcome of 25%. The expected outcome of at least 250 private sector businesses assisted by the CSF was exceeded with 275 businesses or more assisted by the facility.

20. Conditions for the release of the three tranches were met. However, there were delays in meeting the conditions for the MSME policy paper and operation of the CSF due to the turnover and performance of the consultancy team tasked to prepare the strategy and policy paper and provide advisory services on the CSF (para. 13).

21. MSME SDP fully achieved 11 of its 12 output performance targets and partially achieved the 12th. The reduction in the time to register a new business, which was both an outcome and an output target, was partially achieved. The actual time was reduced from 62 days to 36 days, but short of the 30 days target. The key outputs that were fully achieved included (i) the government’s adoption of the MSME Policy, Strategy, and Action Plan in 2012; (ii) the increase in lending of BDBL to MSMEs; (iii) the adoption by BDBL of a 5-year business plan, (iv) the approval by Parliament of the Bhutan Standards Act, (v) the establishment of the BSB, and (vi) the full operation of the CSF. These outputs contributed to the attainment of the expected outcomes. This validation rates the MSME SDP effective in achieving the envisaged outcomes and outputs.

C. Efficiency of Resource Use in Achieving Outputs and Outcomes

22. The PCR rated the MSME SDP efficient. The program was extended for 23 months and the project for 9 months due to consultant turnover, redesign of the CSF, and additional time needed to deploy the CSF after its redesign. Despite the delay in implementation, there was no cost overrun in both the program and project components. The envisaged outcomes were realized within the original budget set at appraisal. While it took time to redesign the CSF, it was an appropriate action that resulted in the full operation of this component. The process of replacing the consultants was necessary to complete a satisfactory MSME Policy, Strategy, and Action Plan. While there were delays caused by consultant turnover and performance, and redesign of the CSF, the expected outcomes and outputs of the program were nonetheless achieved. This validation rates the program efficient.

D. Preliminary Assessment of Sustainability

23. The PCR rated the MSME SDP likely sustainable. The key outputs of the program are likely to be sustainable. The MSME policy paper has drawn out the approach and action points for MSME development. The Department of Cottage and Small Industry responsible for MSME strategy and programs was established and fully staffed. The BDBL has directed its lending programs toward MSMEs using a market-oriented approach and significantly reduced its nonperforming loan ratio. A central registry for secured transactions at the Royal Monetary Authority (RMA) has become fully operational. The BSB was established for the standardization
and certification of product quality. Also, a Regulatory Impact Assessment (RIA) Unit was established to oversee assessments of regulatory impact. The CSF promoted quality BDS that helped strengthen businesses. On the whole, this validation rates the MSME SDP likely to be sustainable.

E. Institutional Development

24. Institutional development of the MSME SDP was rated significant by the PCR. The program established more transparency and accountability through the implementation of RIAs and adoption of the MSME Policy, Strategy, and Action Plan in the work program of DCSI. The process of establishing a new business was shortened, and the capacity of BSB in monitoring product quality and standards was enhanced through the program’s support for institutional capacity building. The establishment of the central registry for movable collateral at the RMA expanded the base of bankable clients for banks. Application for micro-trade registration certificates was made more accessible to businesses in remote areas through acceptance of applications in community centers and regional trade and industry offices. This validation confirms the PCR rating and rates the institutional development of MSME SDP significant.

F. Impact

25. The impact of the MSME SDP was rated significant by the PCR. The impact indicators specified in the DMF were realized. The contribution of the private sector to average annual growth of the GDP increased from 17% during 2004–2007, which were the years prior to MSME SDP, to 20% during 2008–2011. The expected impact on employment was achieved with the share of the private sector and/or MSME-oriented industries to total labor force reaching 10.6% in 2012, exceeding the target of 6.0%. GDP grew by at least 7% since 2009. During 2009–2012, GDP grew by an average of 9%. While the targets for the impact indicators were achieved, this validation notes that in the absence of a counterfactual analysis, the contributions of the private sector to GDP and employment cannot be attributed to the program alone.

26. On policy development and business environment, Bhutan’s strategy for MSME development provided the framework and road map for the sector. The implementation of the RIAs established accountability for new or amended regulations. The reduction in the number of days for starting a new business eased the process for entrepreneurs giving them more certainty in scheduling and estimating startup costs. Starting new businesses in remote areas was also eased with community centers and regional trade and industry offices accepting applications for micro-trade registration certificates.

27. In view of the attainment of the envisaged impact and improvement in the policy and business environment of Bhutan’s MSME sector, this validation rates the impact of the MSME SDP significant.

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III. OTHER PERFORMANCE ASSESSMENTS

A. Performance of the Borrower and Executing Agency

28. The performance of the borrower and the executing agency was rated *satisfactory* by the PCR. Program performance ratings of the MSME SDP in terms of implementation were generally satisfactory. There was adequate coordination among government ministries and key outputs were delivered. By establishing an MSME division, the MEA demonstrated its priority for the program. The government was able to fully comply with the tranche release conditions, although there were delays in complying with the conditions on the adoption of the MSME policy, operation of the CSF, and plan for central registry. The performance of the borrower and executing agency is rated by this validation *satisfactory*.

B. Performance of the Asian Development Bank

29. The PCR rated the performance of ADB *satisfactory*. ADB provided adequate supervision and monitoring of the program. ADB fielded three revision missions, two project grant administration missions, and a project completion review mission. The responsiveness of ADB to the requests of the government and the shortcomings in the original design helped in keeping the program on track. However, this validation notes that adequate appraisal on the suitability of the CSF in Bhutan’s context would have avoided delays in implementing that subcomponent. The performance of ADB is rated by this validation *satisfactory*.

IV. OVERALL ASSESSMENT, LESSONS, AND RECOMMENDATIONS

A. Overall Assessment and Ratings

30. Overall, the PCR rated the MSME SDP *successful*, and this validation also rates it *successful*. The envisaged impact of increased private sector contribution to GDP, increased share of the private sector and/or MSME employment to total labor force, and sustained economic growth were realized. However, this impact cannot be attributed to the program alone (para. 25). The enabling environment for doing business was improved and access to key resources was increased. The envisaged outcome on the increase of BDBL’s portfolio for MSMEs and the number of businesses assisted by the CSF were fully achieved. The expected reduction in the number of days to start a new business was only partially achieved. The program was relevant in addressing the constraints to the development of the MSME sector and to the government’s emphasis on developing this sector. It was less than efficient due to the delays in implementation particularly those of the MSME policy paper, CSF, and central registry, which were key elements of the program. The program outcomes are likely to be sustainable as the overall business environment for the MSMEs has improved.

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B. Lessons

31. This validation agrees with the PCR on the general lessons drawn from the MSME SDP. The clearly defined tranche release criteria provided impetus to achieve the envisaged outcomes and outputs. More involvement by the implementing agency, such as the DCSI, in the design process could have improved impact, particularly for the CSF. There was lack of qualified local consultants and foreign consultants did not fully understand the context in Bhutan for a program such as the MSME SDP. Future programs should adequately account for this risk.

32. This validation agrees with the lessons pointed out by the PCR on the program and project components. The lessons from the program component were (i) the importance of an MSME policy paper, although delayed, in setting the strategy and action plan and a clear work program for DCSI; and (ii) administrative costs could have been reduced and incentives increased for implementing the program preconditions if the three tranches of $2 million were set to just two tranches of $3 million. From the project component, the lessons pointed out were (i) the broader reach realized due to the combination of credit to MSMEs, investment in their capacities, and an enabling environment; and (ii) the strong continuity between an earlier support by ADB for a credit information bureau and the project’s support for a central registry as both initiatives reinforced each other. In addition to the lessons drawn out by the PCR, this validation adds that there should have been adequate assessment at appraisal of the suitability of a new facility such as the CSF, especially in the context of Bhutan where the number of BDS providers is small and where government heavily subsidizes training for BDS.

C. Recommendations for Follow-Up

33. This validation finds the general recommendations of the PCR suitable, especially on the need for consultants advising on program design to be involved also during the early implementation for continuity between design and execution, the implementing agency to be given the opportunity to interview short-listed consultancies, and for the steering committee to have greater enforcement authority.

34. This validation is of the similar view with the PCR that there are further opportunities to strengthen MSMEs particularly in (i) assisting BDBL in upgrading its banking system platform; (ii) providing additional support for the newly established BSB and RMA’s central registry; (iii) implementing the recommendations of the MSME policy, strategy, and action plan; and (iv) establishing a CSF for the import needs of MSMEs, particularly machinery and equipment.
V. OTHER CONSIDERATIONS AND FOLLOW-UP

A. Monitoring and Evaluation Design, Implementation, and Utilization

35. The program design called for the establishment of a project performance management system with the PPMU, which was to generate 6 monthly reports and annual reports. There was no discussion in the PCR on how well this system was used for project monitoring and evaluation. Nonetheless, the PCR reported that the BDBL did not comply with its reporting requirements from 2008 to 2011 due to lack of administrative oversight and began reporting only in 2012.

B. Comments on Project Completion Report Quality

36. The quality of the PCR is *satisfactory*. The report is clear, concise, and consistent with Project Administration Instructions 6.70A.  

9 It has adequate evidence and analysis to substantiate the ratings. The discussion on the achievements in relation to the envisaged outcomes and outputs as specified in the DMF was adequate. Issues in implementation and factors that contributed to the success of the program were clearly discussed. The lessons were carefully thought out and drawn from the findings, and the recommendations were sound. This validation notes a minor error in the PCR on the reference to the number of days to get a business license, which stated that processing time was to be reduced from 62 to 36 days (figure 1, PCR). However, in the report and recommendation of the president (RRP) it was stated that processing time had already been reduced from 62 to 43 days (para. 11, RRP). This validation notes that according to the World Bank data cited in the RRP, at the time of the RRP approval in 2007, the number of days to get a business license was 48.

C. Data Sources for Validation

37. Sources for this validation were the RRP, PCR, back-to-office reports and memorandum of understanding of ADB review missions.

D. Recommendation for Independent Evaluation Department Follow-Up

38. The Independent Evaluation Department may consider conducting a program performance evaluation in 2014 or 2015. This would provide sufficient time for the impact of the policy actions and interventions to be more apparent.

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