

**MICRO, SMALL AND MEDIUM ENTERPRISE  
(MSME) POLICY (2012-2020)  
OF THE KINGDOM OF BHUTAN**



**ROYAL GOVERNMENT OF BHUTAN**

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## ACRONYMS

10 <sup>th</sup> FYP	Tenth Five Year Plan
APIC	Agency for Promotion of Indigenous Crafts
B2B	Business to Business
B2C	Business to Consumer
BCCI	Bhutan Chamber of Commerce and Industry
BDCs	Business Development Centres
BDS	Business Development Services
CSR	Corporate Social Responsibility
CGS	Credit Guarantee Schemes
CIB	Credit Information Bureau
DCSI	Department of Cottage and Small Industry
EDP	Economic Development Policy
G2B	Government to Business
GNH	Gross National Happiness
GNHC	Gross National Happiness Commission
MFI	Micro Finance Institution
MoEA	Ministry of Economic Affairs
NGO	Non-Governmental Organization
PPP	Public-Private Partnership
MSME	Micro, Small and Medium Enterprises
PSDC	Private Sector Development Committee
RGoB	Royal Government of Bhutan
R&D	Research and Development
SEZ	Special Economic Zones
SME	Small and Medium Enterprises
SWOT	Strengths, Weaknesses, Opportunities, Threats
VET	Vocational Education and Training

## 1. INTRODUCTION

Micro, Small and Medium Enterprises (MSMEs) make-up the overwhelming majority (approximately 98%) of all enterprises in most countries, including Bhutan. They are drivers of competitiveness and innovation in many economic sectors and impact directly on employment, equitable opportunities for income and wealth generation, balanced regional development and poverty reduction. As a consequence, most governments develop a MSME Policy to support this important sector of the economy.

The MSME policy of the Royal Government of Bhutan (RGoB) has been developed for the following main reasons:

- To ensure that there is a comprehensive policy for MSME development, given their importance to the overall economy.
- To prepare MSMEs for the challenges of globally integrated markets and the growing levels of competition.
- To ensure that the private sector generally and the MSME sector specifically play an increasing role in fostering economic development.
- To generate employment and support equitable distribution of income and bring about more balanced regional development for poverty reduction.
- To foster the development of the MSMEs by adopting international good practices.

### 1.2 Guiding Framework

The MSME policy is based on the key guiding policies established by the RGoB, namely the:

- Gross National Happiness (GNH) development philosophy.
- 10<sup>th</sup> Five Year Plan (2008-2013).
- Economic Development Policy (2010).
- Bhutan Vision 2020.
- Accelerating Bhutan's Socio-Economic Development Initiative and the Common Minimum Programme of the Royal Government

## 2. CONTEXT

As of June 2010, MSMEs accounted for 98% of all formal-sector enterprises in Bhutan. The MSMEs' percentage share in value added and employment is substantial but no firm estimate is currently available. The main reason for this is the lack of consistent definition of MSMEs across RGoB. The MoEA will henceforth utilise the following definition of MSMEs.

Table 2.1	Employment	Investment
	<b>Large enterprises</b>	100+
<b>Medium enterprises</b>	20 to 99	Nu. 10-100 million
<b>Small enterprises</b>	5 to 19	Nu. 1 – 10 million
<b>Micro enterprises</b>	1 to 4	< Nu. 1 million

*Note: Employment and investment will apply; where there is a conflict, investment will take precedence over employment.*

The RGoB's initiatives to foster development through MSMEs have been focused, since the early 1990s, on a range of issues ranging from enterprise development to cottage industry development. The DTP's manifesto (2008) accorded high priority to MSME development in terms of employment generation and balanced regional and economic development and stressed the importance of establishing an institution to promote and support the growth of MSMEs, including development of support packages, monitor project implementation and provide timely intervention.

In 2010 the RGoB created the Department of Cottage and Small Industry (DCSI) under the Ministry of Economic Affairs (MoEA) to support cottage and small industries, as well as be a key player in the development of the MSME sector.

An overview of the Strengths, Weaknesses, Opportunities and Threats (SWOT) is presented in Annex 1, showing the key issues affecting MSMEs and thus the policy.

### 3. MSME POLICY

The MSME Policy comprises six strategic objectives, consistent with the challenges facing the country, as well as international good practice:

- I. Strengthen the Policy Environment and Institutional Framework.**
- II. Strengthen the Legislative Framework and Enterprise Environment.**
- III. Improve Access to Finance and Incentives.**
- IV. Enhance Competitiveness and Innovation.**
- V. Improve Market Access.**
- VI. Develop a Culture of Entrepreneurship and Human Capital.**

The policies connected with each of the six strategic objectives are discussed in detail below.

#### **I. Strengthen the Policy Environment and Institutional Framework**

*The role of the RGoB is to develop a national policy for the development of the MSME sector until 2020. The national MSME policy must develop the necessary policy environment (strategies, action plans, etc.) and institutional framework to ensure that it is systematically implemented, using both international and national good practices.*

The RGoB will:

**I.1:** Prepare a Strategy for the Development of MSMEs (2012-2020) to establish the vision, targets and strategic objectives based on the MSME Policy.

**I.2:** Develop Action Plans for the Development of the MSMEs to establish the specific activities, responsibilities, timescales and coordination mechanisms to implement the vision and strategic objectives of the Strategy. There will be three action plans covering the period up to 2020.

**I.3:** Reorganise and build the human capital of the Department of Cottage and Small Industry (DCSI) and Department of Industry to ensure effective responsibility for the implementation of the MSME policy, strategy and action plan.

**I.4:** Assess the need for and, depending on the results, establish an MSME Agency (possibly merging with APIC) to focus on the implementation of the MSME Programmes and Projects determined by the MoEA, as well as advocacy and awareness raising on MSME matters.

**I.5:** The MoEA will oversee and coordinate the implementation of the MSME policy, strategy and action plan. However, since MSME development is cross-cutting in nature, there is a need for an inter-ministerial mechanism to ensure effective implementation. The Committee of Secretaries will be the inter-Ministerial Coordination Committee.

**I.6:** Build on the activities of the Private Sector Development Committee to ensure regular, proactive, two-way public private dialogue between the MSME sector and RGoB.

**I.7:** Allocate an Annual Budget for the implementation of the MSME policy, consistent with the annual programming for the MSME strategy/action plan.

**I.8:** Liaise closely with the Gross National Happiness Commission to ensure proactive and effective mobilisation of donor funds to complement and supplement the state funds devoted to MSME development.

## **II. Strengthen the Legislative Framework and Enterprise Environment**

*The role of the RGoB is to develop a regulatory framework and enterprise environment for the development of the MSME sector. This regulatory framework and enterprise environment must stimulate entrepreneurship, thus encouraging more start-ups. At the same time, the regulatory framework and business environment must stimulate growth and profitability of existing MSMEs, by reducing unnecessary and unreasonable cost and other burdens on them (red tape). Finally, the regulatory framework and business environment must facilitate the “exit” of enterprises, ensuring that productive capacities are recycled efficiently.*

The RGoB will:

**II.1:** Prepare and implement an Enterprise Registration Act to ensure that all enterprises become legal entities to ensure symmetry in legal rights and privileges.

**II.2:** Streamline the process of Registration and Licensing (e.g. the Community Centre one-stop-shops, Enterprise Registration Act, on-line registration, etc.) to stimulate entrepreneurship.

**II.3:** Establish a consistent MoEA definition of MSMEs and harmonize the MSME definition of other Ministries to enable coherent data collection, policy development, and impact monitoring and evaluation.

**II.4:** Collect, analyse and disseminate Annual MSME Reports, highlighting trends and issues in relation to the sector.

**II.5:** Assess and improve the Insolvency and Bankruptcy procedures to streamline process, time and cost, so as to ensure that assets of failing enterprises are re-deployed as quickly as possible.

**II.6:** Simplify the tax administration system thus reducing the burden on MSMEs.

**II.7:** Raise the accounting standards of SMEs to align with internationally accepted norms.

**II.8:** Increase MSMEs' access to public procurement opportunities by ensuring that procedures do not discriminate against participation by MSMEs.

**II.9:** Streamline relevant regulations, such as labour market regulations, that impact on MSME development to ensure that procedures developed for large enterprises are not automatically applied to MSMEs.

### **III. Facilitate Access to Finance and Incentives**

*According to the quantitative and qualitative analyses available (MoEA Enterprise Survey, 2010 and 2011; Bhutan Investment Climate Assessment Report 2010), access to finance is considered to be a key priority by enterprises generally and MSMEs specifically. A survey of MSMEs (MoEA, 2010) found that 61% claimed that limited access to finance was a constraint on their development (37% ranked it as a minor constraint, a further 37% ranked it a moderate constraint, and 26% saw it as a major constraint). In this sense, the country is no different from any other economy in the world. Whilst acknowledging the high interest rate and demanding collateral policy of the commercial banks, the RGoB recognises that the market must determine the cost of finance. The policy of the RGoB is to facilitate access to finance through the development of a range of financial tools and intermediaries. Such financial tools and intermediaries will make good use of Bhutanese examples, where these exist, as well as international good practice, customised to the local specificities. By improving access and outreach to finance, the cost of finance will also be reduced over time.*

The RGoB will:

**III.1:** Improve access to commercial bank finance for MSMEs through awareness raising and capacity building on alternative credit appraisal methodologies, thus introducing advanced lending practices and innovative financial products.

**III.2:** Establish Credit Guarantee Schemes (CGSs) to overcome the disincentive of commercial banks to lend to existing MSMEs lacking collateral.

**III.3:** Implement effective Micro Finance Institutions (MFIs), consistent with the RGoB's Financial Inclusion Policy, especially with a focus on economic development and poverty reduction in the rural areas.

**III.4:** Stimulate the development of Financial Leasing and Factoring for MSMEs by commercial banks and specialist leasing companies.

**III.5:** Ensure that the recently established Credit Information Bureau (CIB) contributes to the effective reduction of the collateral requirements and interest rates for MSMEs via effective reduction in asymmetry of information.

**III.6:** Increase MSMEs' access to Equity Finance (venture capital), thus contributing to bridging the financing gaps of growing MSMEs.

**III.7:** Stimulate the development of Business Angels' Networks comprising high net worth individuals willing to invest in and develop MSMEs.

**III.8:** Maximise the potential offered by Public Private Partnerships (PPP) to address financial constraints confronting MSMEs through pilot initiatives.

**III.9:** Under the EDP (2010), the RGoB has set out a series of incentives for the development of the MSME sector, which the MSME policy complements.

**III.10:** Encourage access to raw materials for targeted MSME activities / sub-sectors.

**III.11:** Encourage the use of domestic component requirement for targeted MSME activities / sub-sectors.

**III.12:** Develop further non-fiscal incentives, where these add value to the development of the MSMEs sector, through further studies and pilot initiatives.

#### **IV. Enhance Competitiveness and Innovation**

*The SWOT analysis of the sector (see Annex 1) suggests that future development depends on the ability of MSMEs to increase their competitive and innovation capacities. This is to be stimulated through a palette of infrastructure for entrepreneurship designed to assist both start-ups and established MSMEs with potential for growth, profitability, employment generation and export orientation.*

The RGoB will:

**IV.1:** Develop effective Business Development Services (BDS) infrastructure (private sector, including BCCI, and public sector, including Regional Trade and Industry Offices), which is supportive of MSMEs' development.

**IV.2:** Develop incentives for the MSME sector to engage in R&D/innovative activities via BDS/competitiveness/innovation vouchers and similar initiatives.

**IV.3:** Stimulate the development of Business Cluster and/or Value Chains with the potential to increase the competitiveness of MSME products and services, guided by the MoEA competitiveness studies.

**IV.4:** Stimulate the development of Inter-Enterprise Networks to facilitate development of MSMEs.

**IV.5:** Strengthen the network of Industrial Estates and Service Centres with a focus on MSMEs (see EDP, 2010).

**IV.6:** Develop a network of Business Incubators to accelerate the development of start-up companies through an array of business support services, including access to business premises orchestrated by incubator management.

**IV.7:** Develop Special Economic Zones with a focus on MSMEs (see EDP, 2010).

**IV.8:** Develop Science and Technology Centres/Parks with a focus on MSMEs (see EDP, 2010).

**IV.9:** Support the development of Cooperatives, Farmers' Associations, Community Based Initiatives and similar mechanisms.

**IV.10:** Maximise use of e-business (B2B, G2B and B2C) for the benefit of the MSME sector.

#### **IV. Improve Market Access**

*MSMEs must have access to their clients through markets. Consequently access to markets is a key determinant of enterprise success. Infrastructure and transport limitations are probably the single most critical constraint that MSMEs face with regard to access to markets. Bhutan also has a relatively small market. Moreover, it is located between China and India which enjoy considerable economies of scale due to their large agricultural and manufacturing sectors. Finally, the ASEAN bloc countries are also directly promoting their MSMEs, with the result that the level of competition is increasing over time. Participation in regional and global trade agreements will help MSMEs gain better access to overseas markets, but much will depend on the extent advances are made in development of niche products, improving product variety and quality, improving processing, grading, packaging and labelling and addressing supply-side constraints.*

The RGoB will:

**V.1:** Improve the quality of products and services through the introduction of effective Quality Standards, Testing and Compliance services.

**V.2:** Promote MSME products through “Brand Bhutan”, starting with a focus on the 13 indigenous crafts.

**V.3:** Strategically position goods and services produced by MSMEs in high-value market niches using Bhutan’s Seals of Excellence and Quality, and the Seal of Origin.

**V.4:** Facilitate the participation of export oriented MSMEs in targeted B2B events, Trade Fairs, Exhibitions, etc.

**V.5:** Stimulate product development and quality improvement, ranging from production to final packaging, and focusing on high value markets and niche products.

**V.6:** Facilitate greater awareness raising and compliance with Intellectual Property Rights (IPR) and its advantages for the development of the MSME sector for example as a marketing tool.

**V.7:** Stimulate Franchising, an aspect of IPR, which offers potential for rapid business development and employment generation (excluding “fast-food” type activities, as well as those in the prohibited list).

#### **VI. Develop a Culture of Entrepreneurship and Human Capital**

*Bhutanese society prioritises public administration over enterprise / business yet its key competitors include China, India and the ASEAN bloc countries, all of which emphasise enterprise development. The Tenth Five Year Plan emphasizes that it is critical for a culture of entrepreneurship to be developed at all levels of the education system and all spheres of economic activity, which reinforces the importance of entrepreneurship and the contribution of entrepreneurs to employment generation, wealth creation and poverty reduction (rather than seeing public administration / white collar jobs as the only ideal). The growth of the knowledge economy and rapid developments in consumer preferences, product life cycles, etc. place a premium on the development of a deep and diverse talent pool, combined with a capacity to match labour market demand with the supply of human capital, with an emphasis on gender equality.*

The RGoB will:

**VI.1:** Develop a Culture of Entrepreneurship at all levels of society to stimulate a greater awareness and interest in self-employment and the business sector.

**VI.2:** Embed “entrepreneurship/business” awareness and skills at all levels of the education system.

**VI.3:** Stimulate the participation of MSMEs in School/VET Boards/Academic Boards generating greater linkage between the human capital demanded by the private sector and the skills supplied by the education system.

**VI.4:** Promote Female Entrepreneurship among MSMEs to maximise the economic contribution of both genders.

**VI.5:** Raise the relevance and quality of Vocational Education and Training (VET) skills.

**VI.6:** Stimulate the absorption of new technology and innovation through the development of Research-MSME linkages.

**VI.7:** Generate greater awareness and commitment to Corporate Social Responsibility (CSR).

**VI.8:** Facilitate the circulation of skills, experience and know-how by developing ‘Entrepreneurship Sabbaticals’ for senior civil servants who have completed over ten years’ of service.

## Annex 1: MSME DEVELOPMENT SWOT ANALYSIS<sup>i</sup>

	STRENGTHS	WEAKNESSES
Access to Markets	<ul style="list-style-type: none"> <li>Neighbouring countries provide potentially large export markets, while liberal trade agreements with neighbouring economies assist in accessing export markets</li> <li>Government committed to supporting MSMEs in accessing new domestic and export markets, for example through support to trade fairs</li> <li>The development of even niche products, particularly for export markets, could have a marked impact on the MSME sector</li> <li>Relatively good English language skills aids access to external markets</li> </ul>	<ul style="list-style-type: none"> <li>Small, narrow and dispersed domestic market</li> <li>Poor infrastructure and high transportation and transaction costs</li> <li>Extended transport times and limited logistics support impacting adversely on perishable goods</li> <li>Relatively high costs of domestic production, resulting in competitiveness problems relative to imports.</li> <li>Difficulty in meeting minimum quantity requirements of export markets</li> <li>Insufficient processing, grading, branding, certification and PSP capabilities for export (and foreign tourist) markets</li> <li>Insufficient niche products and niche varieties for export, which could mitigate low economies of scale</li> <li>Inadequate access to market information, e.g. for export</li> </ul>
Access to Human Resources	<ul style="list-style-type: none"> <li>English language literacy high in comparison to many countries in the region</li> <li>Reasonable number of vocational training institutes</li> <li>Awards exist to reward government and private sector individuals for being hardworking and dedicated</li> <li>NGO support for human development exists</li> <li>There is potential to increase productivity through investment in technology</li> <li>Rural-urban migration is good for urban enterprises Availability of cheap pool of labour in border areas</li> </ul>	<ul style="list-style-type: none"> <li>Skills mismatch exists</li> <li>High preference for white collar jobs especially with RGoB</li> <li>Private sector seen as an insecure and unattractive employer (compared to RGoB)</li> <li>High cost of MSME compliance cost with new Employment Law</li> <li>Strong reluctance to take risk amongst population</li> <li>No culture of enterprise</li> <li>High local labour cost and low productivity</li> <li>Restrictions on recruiting foreign workers other than in the border areas)</li> <li>Limited size of work force</li> <li>Educational system encourages youth to join civil service</li> <li>VTI graduates are not taking up jobs in their trained field</li> <li>Decline in traditional skills</li> </ul>
Access to Finance	<ul style="list-style-type: none"> <li>An entrepreneurial culture is developing, resulting in more innovative business projects that can attract financing</li> <li>The commercialization of agriculture supports greater formal lending to this sector</li> <li>Bank efficiency and quality of financial services are improving</li> <li>Arrival of new banks and BDBL up-grade will improve quality and quantity of finance</li> <li>Credit scoring could improve MSMEs' access to finance</li> <li>Gradual trend towards greater financial book-keeping by some MSMEs</li> </ul>	<ul style="list-style-type: none"> <li>Limited financial resources to expand</li> <li>Presence of informal money lenders and usury practices</li> <li>Interest rates officially liberalised, but remain uniform and interest spread is high</li> <li>Strong emphasis placed on collateral and low risk appetite</li> <li>Lack of financial products available, beyond simple credit</li> <li>Limited branch network in rural areas, urban lending bias</li> <li>Fragile (but improving) credit culture</li> <li>Unbalanced loan portfolios in some banks</li> </ul>
Access to Land and Infrastructure	<ul style="list-style-type: none"> <li>Potential for reallocation of GRF/GL for use by MSMEs</li> <li>Cheap and reliable electricity with access to electricity for all by 2013</li> <li>Good access for key sectors to raw materials</li> <li>High potential for organic produce</li> <li>Availability of industrial zones</li> <li>Scenery attractive to tourists</li> </ul>	<ul style="list-style-type: none"> <li>Very difficult land topography (scarce flat land)</li> <li>Complex process on land acquisition (regulations)</li> <li>Conflict in land use between agriculture and enterprise, and between humans and the natural environment</li> <li>Remote areas without access to electricity and water supply problems in some areas</li> <li>Poor allocation of land within industrial estates</li> <li>Land ceiling of 25 acres (individuals) and lease terms of max 30 years</li> </ul>
Access to Enterprise support services	<ul style="list-style-type: none"> <li>Civil sector organisations (BCCI &amp; affiliates) exist</li> <li>Programme of commodity chain studies (MoAF)</li> <li>Rural outreach services for agriculture-related enterprises exist</li> <li>Government business start-up training programme for vocational college exists</li> </ul>	<ul style="list-style-type: none"> <li>Most existing private sector BDS providers are not focused on provision of services to MSMEs</li> <li>Small and ineffective BDS market, limited supply/demand</li> <li>BCCI and affiliates offer limited services to members</li> <li>Specialist BDS provision is not available within Bhutan</li> <li>Legal status issues exist for business intermediary organisations, producers' groups and cooperatives</li> <li>Government business start-up training programme for vocational college are severely limited by state budget</li> <li>Very limited advocacy/lobbying by business organisations</li> <li>Concept of BDS not well understood by stakeholders</li> </ul>

	OPPORTUNITIES	THREATS
Access to Markets	<ul style="list-style-type: none"> <li>• Differing seasonality presents export opportunities, while growing international demand for organic products may increase agricultural exports in niche product areas</li> <li>• Bilateral and/or multilateral trade agreements with neighbouring and third countries</li> <li>• Increased FDI inflows may support improved export market access</li> <li>• Increased international donor assistance could support better access to markets</li> </ul>	<ul style="list-style-type: none"> <li>• Landlocked country makes exporting more challenging</li> <li>• Threat of increased protectionism impacting on Bhutan exports, such as higher PSP standards being imposed</li> <li>• Threat of neighbouring countries imposing constraints on trans-shipment of Bhutan exports to third countries</li> </ul>
Access to Human Resources	<ul style="list-style-type: none"> <li>• Donor support to HR development may increase</li> <li>• Government of India/other bilateral donors might provide subsidies for vocational training</li> </ul>	<ul style="list-style-type: none"> <li>• "Brain drain"</li> <li>• Increasing productivity gap with regional competitors</li> </ul>
Access to Finance	<ul style="list-style-type: none"> <li>• Greater FDI inflows may increase capital flows to MSMEs</li> <li>• Greater international donor support for MSME development could improve access to finance</li> </ul>	<ul style="list-style-type: none"> <li>• Foreign exchange risks (e.g. the Indian rupee against third currencies)</li> <li>• A decline in international donor support could have an adverse impact on the economy, and also negatively impact on access to finance</li> </ul>
Access to Land and Infrastructure	<ul style="list-style-type: none"> <li>• Pristine environmental image creates opportunities for organic food, tourism, etc.</li> <li>• Growth in global market for agricultural produce</li> <li>• Cheap electricity creates opportunity to develop high energy using but clean enterprises</li> </ul>	<ul style="list-style-type: none"> <li>• Negative changes in Indian Government energy policy could have serious impact</li> <li>• Natural catastrophes (floods, etc.)</li> <li>• Over-dependence on import of many raw materials from India</li> </ul>
Access to Enterprise support	<ul style="list-style-type: none"> <li>• Greater FDI inflows may increase capital flows to MSMEs</li> <li>• Greater international donor support for MSME development could assist in improving access to finance</li> </ul>	<ul style="list-style-type: none"> <li>• Offers of direct aid and delivery of enterprise support distorts local market pricing mechanisms (supply &amp; demand) and obstructs local BDS market development</li> <li>• Uncontrolled FDI can result in transfer of ownership of local capacity to foreign owners, and outward flows of profits</li> <li>• Government failure to respond in time and sufficiently to build local competitiveness in domestic and export markets may result in permanent loss of opportunity</li> </ul>

<sup>i</sup> Note: SWOT Analysis prepared based on workshops involving MOEA and other MSME stakeholders.