

**COTTAGE, SMALL AND MEDIUM INDUSTRY POLICY
OF
THE KINGDOM OF BHUTAN, 2012**



ROYAL GOVERNMENT OF BHUTAN



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MINISTRY OF ECONOMIC AFFAIRS

ROYAL GOVERNMENT OF BHUTAN

Tashichho Dzong

THIMPHU



བསྟན་ཀྱིས་ སློབ་པོ།

MINISTER

September 2012

Foreword

The growth of cottage, small and medium industry is key to poverty alleviation, employment generation and sustainable economic development of our country. These industries constitute more than 98% of our total industry.

Cottage, small and medium industry stimulate pro-poor growth with equity and inclusion, promote balanced regional development and help strengthen our rich cultural heritage. They contribute meaningfully towards the realization of the noble vision of achieving Gross National Happiness. Indeed, it is for this reason that the Bhutan Vision 2020 and the Economic Development Policy 2010 identifies and deems "small and cottage industries" as a priority sector.

However, on account of their size, cottage and small industries are particularly prone to many constraints; such as low economy of scale, limited access to finance, limited investment in modern technologies and access to lucrative markets. Addressing these constraints is a daunting task calling for a holistic approach. The first step towards this is the formulation of a comprehensive Policy to provide the enabling and conducive environment for the growth of cottage, small and medium industries in the country.

This Policy outlines six strategic areas: (i) strengthening the policy environment and institutional framework; (ii) strengthening the legislative framework and enterprise environment; (iii) facilitate access to finance and incentives; (iv) enhance competitiveness and innovation; (v) improve market access; and (vi) enhance employment and develop a culture of entrepreneurship. The Policy will be backed up by the Development Strategy (2012-2020) document and a series of Action Plans (2012-2014; 2015-2017; 2018-2020).

The Policy aims to provide a clear direction for the development of cottage, small and medium industry; to prepare them for the opportunities and challenges of globalization; to ensure that they play an increasing role in fostering economic development; to generate employment and support equitable distribution of income and bring about balanced regional development.



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The Policy has been two years in the making. It was prepared in full consonance with the principles of GNH and is supported by evidence from numerous surveys and studies and feedback emanating from a wide range of consultations with stakeholders both within the government as well as in the private sector.

On behalf of the Royal Government, I extend our deep appreciation to the Asian Development Bank for supporting us on this important initiative. I would also like to thank all the stakeholders for their active engagement and valuable inputs that went into the formulation of the Policy and the supporting documents. On behalf of the Ministry of Economic Affairs, I request all stakeholders to continue to provide the same level of cooperation and assistance in implementing and realizing the Policy, Development Strategy and the Action Plans.

Finally, I urge all agencies – government and non-government, public and private, individuals and business associations - to take advantage of this Policy and work towards a vibrant and sustainable growth of our cottage, small and medium enterprise sector, for the benefit of our country and its people.

With my best wishes and Tashi Delek.

(Khandu Wangchuk)

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Acronyms

10 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
BDS	Business Development Services
CSR	Corporate Social Responsibility
CGS	Credit Guarantee Scheme
CIB	Credit Information Bureau
CSMI	Cottage, Small and Medium Industry
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
PSDC	Private Sector Development Committee
RGoB	Royal Government of Bhutan
R&D	Research and Development
SEZ	Special Economic Zones
SMI	Small and Medium Industry
TVET	Technical and Vocational Education Training

1. Introduction

Cottage, Small and Medium Industry (CSMI) make-up an overwhelming majority (approximately 98%) of all industries in most countries, including Bhutan¹. 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 CSMI Policy to support this important sector of the economy.

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

- To ensure that there is a comprehensive policy for CSMI development, given their importance to the overall economy.
- To prepare CSMI for the challenges of globally integrated markets and the growing levels of competition.
- To ensure that the private sector generally and the CSMI 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 CSMI by adopting international good practices.

The CSMI policy is based on the Gross National Happiness (GNH) development philosophy and other key guiding principles reflected in important RGoB documents, namely:

- Bhutan Vision 2020.
- 10th Five Year Plan (2008-2013).
- Economic Development Policy (2010).
- Accelerating Bhutan's Socio-Economic Development Initiative, and,
- Common Minimum Programme of the Royal Government

2. Vision

- To develop a dynamic, competitive and innovative CSMI sector in harmony with the GNH philosophy, thus promoting employment, poverty reduction and balanced regional development.

3. Mission

- Nurture a culture of entrepreneurship that encourages innovation, creativity and enterprise.
- Ensure that CSMI become dynamic, outward-looking and capable of generating profits and wealth across the country.
- Ensure that CSMI contribute to employment generation.
- Ensure that CSMI contribute to alleviation of poverty, especially in rural areas.

4. Objective

The overall objective of the policy is to foster job creation and enhance income generation by promoting the creation of new CSMI and improving the performance and competitiveness of existing ones to increase their participation and contribution to the Bhutanese economy.

5. Context

The CSMI nomenclature is used to mean cottage, small and medium industry. The CSMI cover non-farm economic activities mainly manufacturing, mining, construction and services. There is no universally accepted definition of CSMI. Different countries use various measures of size, depending on their level of development. The commonly used yardsticks are total number of employees, total investment and sales turnover.

In the context of Bhutan, cottage industries are those industries with an investment of less than Nu.1 million and engaging up to 4 people. Small industries are undertakings engaging between 5 and 19 employees with investment from Nu.1 to Nu.10

million. Medium industries employ between 20 to 99 people with investment from Nu.10 to Nu.100 million and large industries are undertakings with an investment of more than Nu.100 million employing 100 or more employees. The definition is illustrated in the table below

Scale of industry	Employment Size	Investment (million Nu.)
Cottage	1 to 4	< 1
Small	5 to 19	1 – 10
Medium	20 to 99	10 - 100
Large	100 +	> 100

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

The Royal Government of Bhutan (RGoB) accords high priority to the development of CSMI as they play a crucial role in employment creation, income generation and in bringing regional balanced development. They are more easily established since their requirements in terms of capital, technology, management and even utilities are not as demanding as it is the case for large industries. The RGoB's initiatives to foster development through CSMI have been focused since the early nineteen nine-ties. Initiatives ranging from entrepreneurship development programme and special loan schemes to cottage and small industry development activities have been implemented in the past.

In 2010 the RGoB established the Department of Cottage and Small Industry (DCSI) under the Ministry of Economic Affairs (MoEA) to support the national cottage and small industry development.

6. CSMI Policy

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

- Strengthen the Policy Environment and Institutional Framework.
- Strengthen the Legislative Framework and Enterprise Environment.

- Facilitate Access to Finance and Incentives.
- Enhance Competitiveness and Innovation.
- Improve Market Access.
- Enhance Employment and Develop a Culture of Entrepreneurship

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

6.1. Strengthen the Policy Environment and Institutional Framework

The role of the RGoB is to develop a national policy for the development of the CSMI sector until 2020. The national CSMI 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 shall:

- 6.1.1. Prepare a Strategy for the development of CSMI (2012-2020) to establish the vision, targets and strategic objectives based on the CSMI Policy.
- 6.1.2. Develop Action Plans for the development of the CSMI to establish the specific activities, responsibilities, time scales 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.
- 6.1.3. Reorganise and build the human capital of the Department of Cottage and Small Industry (DCSI) and Department of Industry to provide effective responsibility for the implementation of the CSMI policy, strategy and action plan.
- 6.1.4. Assess the need for and, depending on the results, establish CSMI Agency (possibly merging with the Agency for Promotion of Indigenous Crafts or APIC) to focus on the implementation of the CSMI

programmes and projects, as well as advocacy and awareness-raising on CSMI matters.

- 6.1.5. Entrust the MoEA to oversee and coordinate the implementation of the CSMI policy, strategy and action plan. However, since CSMI development is cross-cutting in nature, there is a need for an inter-ministerial mechanism to ensure effective implementation. The Committee of Secretaries (CoS) will be the inter-ministerial coordination committee.
- 6.1.6. Build on the activities of the Private Sector Development Committee (PSDC) to ensure regular, proactive, two-way public private dialogue between the CSMI sector and the RGoB.
- 6.1.7. Liaise closely with the Gross National Happiness Commission (GNHC) Secretariat to ensure proactive and effective mobilisation of donor funds to complement and supplement the state funds devoted to CSMI development.

6.2. 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 CSMI sector. This regulatory framework and enterprise environment must stimulate entrepreneurship, thus encouraging more start-ups, including a greater emphasis on potential new areas of growth, such as green/eco-friendly industries. At the same time, the regulatory framework and business environment must stimulate growth and profitability of existing CSMI, 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 shall:

- 6.2.1. Prepare and implement an Enterprise Registration Act to ensure that all enterprises become legal entities to ensure symmetry in legal rights and privileges.
- 6.2.2. 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.
- 6.2.3. Establish a consistent MoEA definition of CSMI and harmonize the definitions of other ministries to enable coherent data collection, policy development, and impact monitoring and evaluation.
- 6.2.4. Collect, analyse and disseminate Annual CSMI Reports, highlighting trends and issues in relation to the sector.
- 6.2.5. Assess and improve the insolvency and bankruptcy procedures to streamline process, time and cost, so as to ensure that assets of failing industries are re-deployed as quickly as possible.
- 6.2.6. Simplify the tax administration system thus reducing the burden on CSMI.
- 6.2.7. Raise the accounting standards of Small and Medium Industry (SMI) to align with internationally accepted norms.
- 6.2.8. Increase CSMI's access to public procurement opportunities by ensuring that public procurement favours products and services locally produced or provided and that has low ecological footprints.
- 6.2.9. Streamline relevant regulations, such as labour market regulations, that impact on CSMI development to ensure that procedures developed for large industries are not automatically applied to CSMI.

6.3. 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 CSMI specifically. A survey of Enterprises (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 shall:

- 6.3.1. Improve access to commercial bank finance for CSMI through awareness raising and capacity building on alternative credit appraisal methodologies, thus introducing advanced lending practices and innovative financial products.
- 6.3.2. Expand the existing Credit Guarantee Schemes (CGS) to overcome the disincentive of commercial banks to lend to existing CSMI lacking collateral.
- 6.3.3. Implement effective Micro Finance Institutions (MFI), consistent with the RGoB's Financial Inclusion Policy, especially with a focus on economic development, gender equality and poverty reduction in the rural areas.
- 6.3.4. Stimulate the development of financial leasing and factoring for CSMI by commercial banks and specialist leasing companies.

- 6.3.5. Ensure that the recently established Credit Information Bureau (CIB) contributes to the effective reduction of the collateral requirements and interest rates for CSMI via effective reduction in asymmetry of information.
- 6.3.6. Increase CSMI's access to equity finance (venture capital), thus contributing to bridging the financing gaps of growing CSMI.
- 6.3.7. Stimulate the development of Business Networks comprising high net worth individuals willing to invest in and develop CSMI.
- 6.3.8. Maximise the potential offered by Public Private Partnerships (PPP) to address financial constraints confronting CSMI through pilot initiatives.
- 6.3.9. Provide incentives for the development of the CSMI sector, in line with the EDP (2010). Priority would be given to sustainable, green and service industries.
- 6.3.10. Facilitate access to raw materials for targeted CSMI activities / sub-sectors.
- 6.3.11. Encourage the use of domestic component requirement for targeted CSMI activities / sub-sectors.
- 6.3.12. Develop further non-fiscal incentives, where these add value to the development of the CSMI sector, through further studies and pilot initiatives.

6.4. Enhance Competitiveness and Innovation

The SWOT analysis of the sector suggests that future development depends on the ability of CSMI 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 CSMI with potential for growth, profitability, employment generation and export orientation. This will include an emphasis on eco-friendly businesses and green technologies.

The RGoB shall:

- 6.4.1. Develop effective Business Development Services (BDS) infrastructure (private sector, including BCCI, and public sector, including Regional Trade and Industry Offices), which is supportive of CSMI's development.
- 6.4.2. Develop incentives for the CSMI sector to engage in R&D/ innovative/ green industry activities via BDS/ competitiveness/ innovation vouchers and similar initiatives in collaboration with Royal University of Bhutan.
- 6.4.3. Stimulate the development of business cluster and/or value chains with the potential to increase the competitiveness of CSMI products and services, guided by the MoEA competitiveness studies.
- 6.4.4. Stimulate the development of Inter-Enterprise Networks to facilitate development of CSMI.
- 6.4.5. Strengthen the network of industrial estates and service centres with a focus on CSMI in line with the EDP, 2010.
- 6.4.6. 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.
- 6.4.7. Develop Special Economic Zones with a focus on CSMI (see EDP, 2010).

- 6.4.8. Develop Science and Technology Centres/ Parks with a focus on CSMI (see EDP, 2010).
- 6.4.9. Support the development of Cooperatives, Farmers' Associations, Community Based Initiatives and similar mechanisms.
- 6.4.10. Maximise use of e-business (B2B, G2B and B2C) for the benefit of the CSMI sector.

6.5. Improve Market Access

CSMI 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 CSMI 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 CSMI, with the result that the level of competition is increasing over time. Participation in regional and global trade agreements will help CSMI 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 shall:

- 6.5.1. Improve the quality of products and services through the introduction of effective quality standards, testing and compliance services.
- 6.5.2. Promote CSMI products through "Brand Bhutan", starting with a focus on indigenous arts and crafts of Bhutan.
- 6.5.3. Strategically position goods and services produced by CSMI in high-value market niches using Bhutan's Seals of Excellence and Quality, the Seal of Origin, Bhutan Organic Logo and Green Labelling.

- 6.5.4. Facilitate the participation of export oriented CSMI in targeted B2B events, trade fairs and exhibitions.
- 6.5.5. Stimulate product development and quality improvement, ranging from production to final packaging focusing on high value markets and niche products.
- 6.5.6. Facilitate greater awareness raising and compliance with Intellectual Property Rights (IPR) and its advantages for the development of the CSMI sector for example as a marketing tool.
- 6.5.7. Stimulate franchising, an aspect of IPR, which offers potential for rapid business development and employment generation (excluding “fast-food” chains and other business activities included in the prohibited list).

6.6. Enhance Employment and Develop a Culture of Entrepreneurship

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, low carbon business, wealth creation, environmental and social protection, 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 shall:

- 6.6.1. Develop a culture of entrepreneurship at all levels of society to stimulate a greater awareness and interest in self-employment and the business sector, including the development of a green mindset.

- 6.6.2. Embed “entrepreneurship/ green business culture” awareness and skills at all levels of the education system. Promote innovation amongst students through provision of financial and technical resources for research and development.
- 6.6.3. Stimulate the participation of CSMI in School/ Technical & Vocational Education Training Boards/ Academic Boards generating greater linkage between the human capital demanded by the private sector and the skills supplied by the education system.
- 6.6.4. Promote women entrepreneurship in CSMI to maximise the economic contribution of both genders.
- 6.6.5. Raise the relevance and quality of Technical & Vocational Education Training skills through closer links between technical training institutes and industries.
- 6.6.6. Stimulate the absorption of new technology (including clean technologies) and innovation through the development of Research-CSMI linkages.
- 6.6.7. Generate greater awareness and commitment to Corporate Social Responsibility (CSR).

7. The Way Forward

The CSMI development framework comprises of three inter-related instruments:

- CSMI Policy sets out the overall policy framework for CSMI development until 2020.
- CSMI Development Strategy (2012-20) sets out the strategies and measures for achieving the CSMI Policy and
- CSMI Action Plan (2012-2014) which sets out the activities, responsibilities, deadlines and resources for achieving the CSMI Development Strategy in three year phases; there will be three such CSMI Action Plans covering the overall timeline of the CSMI Policy and Strategy.