

REPUBLIC OF RWANDA



MINISTRY OF TRADE AND INDUSTRY

Small and Medium Enterprises (SMEs) Development Policy

June 2010

List of Abbreviations

ACDI/VOCA	Agricultural Cooperative Development International / Volunteers in Overseas Cooperative Assistance
AFSR	Appui à la Filière Semencière au Rwanda
AGOA	African Growth and Opportunity Act
BDS	Business Development Services Center
BITC	Business in the Community UK
BRD	Rwanda Development Bank
BMNZ	Business Mentors New Zealand
BNR	National Bank of Rwanda
CAPMER	Centre d'Appui aux Petites et Moyennes Entreprises
CEDP	Competitiveness and Enterprise Development Project
CHAMP	Community HIV/AIDS Mobilization Project
COMESA	Common Market of East Africa
CRS	Catholic Relief Services
DM	Development Marketplace
EAC	East African Community
EDPRS	Economic Development and Poverty Reduction Strategy
FHI	Family Health International
FSDP	Financial Sector Development Plan
FSDS	Financial Sector Development Secretariat
GDP	Gross Domestic Product
GoR	Government of Rwanda
GTZ	Deutsche Gesellschaft für Technische Zusammenarbeit (German Development Agency)
ICT	Information, Communication and Technology
IFAD	International Fund for Agricultural Development
IMF	International Monetary Fund
IPAR	Institute of Policy Analysis and Research
IT	Information Technology
JICA	Japan International Cooperation Agency
KIST	Kigali Institute of Science and Technology
MFI	Microfinance Institution
MINECOFIN	Ministry of Finance and Economic Planning
MINEDUC	Ministry of Education
MINICOM	Ministry of Trade and Industry
MINALOC	Ministry of Local Government
MINIYOUTH	Ministry of Youth
MSME	Micro, Small and Medium Enterprise
NGO	Non-governmental Organization
PDCRE	The Smallholder Cash and Export Crops Development Project
PDRCIU	Umutara Community Resource and infrastructure development project
PPPME-II	Rural Small/Micro Enterprises Promotion Project Phase II
PSF	Private Sector Federation
RADA	Rwanda Agriculture Development Agency
RARDA	Rwanda Animal Resources Development Agency
RBS	Rwanda Bureau of Standards
RCA	Rwanda Cooperative Agency
REMA	Rwanda Environmental Management Authority
RDB	Rwanda Development Board
REIC	Rwanda Enterprise Investment Company
RITA	Rwanda Information Technology Agency

RRA	Rwanda Revenue Authority
RWF	Rwandan Franc
SFB	School of Finance and Banking
SIDO	Small Industries Development Organization Tanzania
SME	Small and Medium Enterprise (including micro enterprises)
SNV	Non-Profit international development organization
TVET	Technological and Vocational Education and Training
UNIDO	United Nations Industrial Development Organization
USAID	United States Agency for International Development
USADF	US Africa Development Foundation
USD	United States Dollars
UYF	Umsobomvu Youth Fund
VAT	Value Added Tax
WED	Women Entrepreneurship Development Program

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1.0 Issue

The Government of Rwanda (GoR) has a vision to become a middle-income country¹. In order to achieve this goal the medium term Economic Development and Poverty Reduction Strategy (EDPRS) states that it must achieve an annual GDP growth rate of 8.1% and increase off-farm employment to 30% by 2012.

Small and Medium Enterprises (SMEs) and micro enterprises in Organization for Economic Cooperation and Development (OECD) countries account for over 95% of all firms, 60-70% of employment and 55% of GDP and create the majority of new jobs, indicating the impact SMEs have on employment. In contrast, currently over 80% of Rwandans are engaged in agricultural production. The SME sector, including formal and informal businesses, comprises 98% of the businesses in Rwanda and 41% of all private sector employment — though the formalized sector has much growth potential with only 300,000 currently employed. Most micro and small enterprises employ up to four people, showing that growth in the sector would create significant private sector non-agricultural employment opportunities.

The SME sector also has the potential to lower Rwanda's trade imbalance. Rwanda's trade deficit has grown from \$229m to an estimated \$770m over the past five years (2005 to 2009). The GoR's vision is to increase the role of value-added exports to increase export revenue and reduce the import-export gap.

The GoR is dependent on external grants and borrowing for 48% of government revenue. The GoR seeks to reduce its dependency on foreign aid and debt by increasing internal tax revenue. Tax revenues increased by 10% in 2009 compared to the previous year, largely from the collection of Value Added Tax (VAT). According to a study by the Institute for Policy Analysis and Research (IPAR), SMEs currently generate 4.9 billion RwF in annual tax revenue. Of the estimated 72,000 SMEs in the country 25,000 are registered and of those registered only 24% pay tax on a regular basis. In addition to expanding the export sector, SMEs also represent a potential source of tax revenue, thus reducing Rwanda's dependence on foreign assistance.

SMEs in Rwanda have remained less competitive compared to regional neighbors and if no effort is made to make them more competitive, this situation is likely to worsen with the full-fledged East African Community (EAC) common market, which Rwanda is set to enter in July 2010. Making existing and new Rwandan SMEs more competitive in value added exports is therefore one among other vital actions necessary to reverse the trade imbalance and build competitiveness.

Despite the above, there has not been a coordinated policy to address the SME landscape and unlock the underlying potential of SMEs in national development. In order to contribute to achieving increased off-farm employment and tax revenue, the GoR needs to implement a

¹ These targets are subject to periodic review

coherent and coordinated policy to create an enabling environment for the growth of the SME sector in Rwanda.

2.0 Context

2.1 *Interaction with other policies*

The Rwandan Small and Medium Enterprise (SME) Policy is designed to complement a set of existing policies/strategies that aim to increase non-farm employment, develop business and technical skills in the Rwandan workforce, support targeted value-added clusters, strengthen the financial sector, grow the tax base and facilitate investment finance to generate industrial growth.

Sector and business “cluster development” is widely regarded as one of the most effective ways of encouraging and supporting inter-firm collaboration, institutional development and industry-wide growth. Such collaboration can optimize SME structures and facilitates utilization of knowledge and expertise and access to the latest technologies, equipment and financial products and services. There have been several recent policies developed by the GoR that focus on cluster development for value-addition sectors to increase Rwanda’s international competitiveness, create more opportunities, expand the supply of skilled people and technology, expand the local supplier base, increase efficiency and productivity and foster innovation

The SME policy will support these policies for SME clusters in a particular field that can be linked by commonalities by improving **productivity / efficiency and by stimulating and enabling innovation, facilitating commercialization and new business formation.**

The SME policy is supported by the following policies, laws and strategies:

- Organic Law Determining the Use and Management of Land in Rwanda (2005)
- Trade Policy (2006)
- Industrial Policy (2006)
- Handcraft Policy (2006)
- National Policy on the Promotion of Cooperatives (2006)
- Economic Development and Poverty Reduction Strategy (EDPRS-2007)
- National Microfinance Policy and Implementation Strategy (2007)
- Financial Sector Development Plan (2007)
- Rwanda Tea Strategy (2008)
- Rwanda Coffee Strategy (2008)
- Strategic Plan for the Transformation of Agriculture in Rwanda (2009)
- Technical and Vocational Education and Training (TVET) policy (2009)
- Companies Act (2009)
- Law Regulating Labour in Rwanda (2009)
- National Savings Mobilization Strategy
- SACCO (Savings and Credit Cooperatives) Strategy (2009)
- MINICOM Strategic plan 2009-2012
- Rwanda Craft Industry Strategic Plan (2009-2013)

- Special Economic Zone Policy (2010 draft)
- Mining Policy (2010)
- Tourism Policy and Master Plan (2010)
- Hides and Skins Policy (2010 draft)
- Intellectual Property Policy (2010)
- Competition and Consumer Protection Policy and Act (2010 draft)

All the above policies are supporting policies to the SME policy, the unifying factor being their impact on Rwanda’s competitiveness. Several of these policies address challenges faced by SMEs, but that also impact other socio-economic activities—thus falling outside the direct purview of this policy. These include limited access to electricity and transport, which is addressed in the industrial and trade policy respectively (with new draft policies currently up for review in these areas) as well as the organic land law of 2005, which drives land reform and redistribution in Rwanda and the TVET (Technical and Vocational Education and Training) policy designed to build a skilled workforce and provide job opportunities for youth. The SME policy creates a unified set of strategies that build from these policies to further target programming to support SME growth. This policy contains several strategies that help coordinate programs within existing policies as well as presenting several additional options that specifically target the needs of SMEs.

2.2 SMEs Definition

For the purposes of this policy, SMEs are to be considered based on the following conditions (in line with the World Bank report of 2004) whereby two of the three conditions must be met. For the avoidance of doubt, in this policy when using the popular term “SME”, it is taken to include micro enterprises as well as small and medium enterprises. Registered cooperatives may also benefit from this policy in so far as they are SMEs.

Size of the Enterprise	Net capital investments (Million RwF)	Annual Turn over (Million RwF)	Number of Employees
Micro Enterprises	Less than 0.5	Less than 0.3	1 to 3
Small Enterprises	0.5 to 15	0.3 to 12	4 to 30
Medium Enterprises	15 to 75	12 to 50	31 to 100
Large Enterprises	More than 75	More than 50	More than 100

Notes on definition

- *Two of the three conditions should be met*
- *Rwanda Revenue Authority (RRA) has a different definition of SMEs for tax purposes*
- *Informal companies are defined as those not registered in accordance with the Companies Act or other legislation related to SMEs and cooperatives*
- *In this policy, SME is used to describe micro as well as small and medium enterprises*

Throughout the policy, value-added clusters are referenced. The key value clusters, **as identified within several existing national plans/strategies** that have been prioritized in this policy are:

General Clusters		Product specific prioritized Clusters for SME Development with Value-addition ²		Broad RDB priority Clusters
<ul style="list-style-type: none"> ▪ Tourism ▪ Agro-processing ▪ Mining ▪ Handicrafts ▪ Cut flowers ▪ Pharmaceuticals ▪ Textiles ▪ ICT software development ▪ Packaging ▪ Business Process Outsourcing (BPO) 	→	<ul style="list-style-type: none"> ▪ Sericulture ▪ Essential Oils ▪ BPO ▪ Agro-processing ▪ Cheese ▪ Light Metal Industries ▪ Creative Industries 	→	<ul style="list-style-type: none"> ▪ Specialized Tourism ▪ Sericulture (Silk) ▪ Fruits & Vegetables ▪ ICT Services (BPO) ▪ Dairy Products ▪ Mining³

SMEs can and do already play a role in these target clusters along the entire value chain from raw material and input supply to processing and export, signaling the significant contribution they can make in expanding the value added sector.

2.3 Previous SMEs initiatives

Rwanda has seen a variety of initiatives to support Rwandan SMEs from the government, Development Partners (DPs), financial and non-governmental organization (NGO) sectors. However, these initiatives have suffered from a lack of resources, coordination and capacity. Limited and disparate implementation of the majority of these projects makes it difficult to adequately assess their success or failure.

Within the government supported sector the most prominent of these initiatives was the former Centre d'Appui aux Petites et Moyennes Entreprises (CAPMER), a public/private institution mandated to provide training, advice and technical support to SMEs. However, this

² Prioritized Clusters for SME Development with Value-addition also involve:

Sericulture cluster includes: Silk and Bamboo

Essential Oils: pyrethrum, jetropha, geranium

BPO: software development, back office operations, call centres

Agro-processing: cassava, irish potatoes, cooking oil, tomatoes, maize, wheat, fruits & vegetables

Cheese: creation of cheese marketing company from Cooperatives linked to the "one-cow-per family" programme

Light Metal Industries: production of small spare parts and electric motors

Creative Industries: film, cultural shows, music, handicrafts

³ This list is not exhaustive

institution lacked the capacity and resources to provide the necessary support to develop the SME sector. In 2009, CAPMER was integrated into the Rwanda Development Board (RDB) in order to combine its mandate with export and investment promotion and general private sector development services.

The RDB was formed to coordinate and combine all services and support for Rwandan private sector development including investment and export support, business registration, environmental and tax advice, free trade zone and IT development and cluster specific programs such as tourism development. RDB's vision to transform Rwanda into a dynamic global hub for business investment and innovation focuses on the macro situation in Rwanda. The RDB provides several specific initiatives to support SMEs, including training programs, networking and moveable asset registration, in addition to working to improve the overall business environment in Rwanda. The broad high-level mandate of RDB makes the ground-level implementation of SME programming difficult with existing resources.

Specific agencies have also been created to support the development of Rwandan cooperatives, whose business activities are similar to SMEs, though they have a different taxation and registration procedure. The Rwanda Cooperative Agency (RCA) works to train and regulate cooperatives in tandem with the Rural Small/Micro Enterprises Promotion Project Phase II (PPMER-II), a project in MINICOM, mandated to provide marketing and other support to cooperatives and SMEs in rural areas.

Supported by the GoR, though a private sector member based institution, the Private Sector Federation (PSF) was formed to represent the interests of the private sector vis-à-vis the GoR. Working through organized chambers, PSF collects information from private sector actors, provides training and support to these actors and advocates for their needs. PSF runs a network of Business Development Service Centers (BDS) under a new model of independent BDS providers within the framework of private/private partnerships, responding to previous program failures which indicated that pure government sponsorship was costly and ineffective. PSF also hosts an annual business plan competition to support youth in business, which has grown from 10 to 100 winners a year. Winners receive guaranteed loans from partner banks.

The financial sector is also working to support Rwandan SMEs through financing mechanisms. A large proportion of the Rwanda Development Bank's (BRD) lending activities provide direct financing to SMEs and cooperatives, refinancing to microfinance institutions, equity financing and equipment leasing through agricultural and other loan funds. These loans provide financing primarily for agricultural production activities, in marketing as well as processing, and through non-agricultural activities such as tourism, ICT, social infrastructure, manufacturing and services. Other lending facilities, managed by commercial banks as well as Micro-finance Institutions (MFI), target women, cooperatives, youth and agro-business.

Development Partners (DPs) contributed as well to the development of SMEs. USAID set up an SME guarantee fund that has been managed by the Bank of Kigali. Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) and the World Bank have been involved in skills training and entrepreneurship development. International Fund for Agricultural Development (IFAD) has also been involved through projects like PDRCIU, PDCRE and PPPMER, which have been

operational over the last five years and have directly contributed to the development of agricultural and non agricultural rural SMEs. Other development partners include Belgian Technical Cooperation (BTC) through AFSR and PADL Gakenke, Dutch cooperation through ROPARWA, SNV and TERRAFINA and United States African Development Foundation (USADF) through its enterprise development program. Local initiatives include the pro-femme twese hamwe.

These initiatives demonstrate a concerted will on the part of all players to provide support to SMEs and show that public and private institutions have a wealth of experience to share in the implementation of this policy.

2.4 Rationale for the new SMEs policy

Small and medium enterprise strength comes from the ability of smaller firms to react quickly and flexibly to adapt to market realities and to take advantage of opportunities that would not be an advantage to larger firms. Small enterprises grow to medium enterprises as they are increasingly able to develop the resources to expand out of their local economic system. Thousands of small companies operating at the micro level, taking advantage of local resources and opportunities, form the base of a healthy economy by providing local services, jobs and supplying or processing for larger firms and markets.

Although substantial supporting initiatives had been undertaken by the GoR, they have failed to create the enabling environment necessary to develop the sector. Key challenges include:

1. **Limited resources and human capacity** for previous initiatives meant they were unable to fulfill the mandate of SME development or to extend their services country-wide
2. **Limited coordination and partnership** in these initiatives meant that many ongoing activities, in the public and private sector, were not sufficiently connected and harmonized to maximize their potential for SME development
3. A **limited policy environment** lacking focus and a prioritization of cluster and sector specific policies meant that the general policy environment was not targeted at SMEs
4. The **structure of previous finance schemes**, by placing them in large intermediary institutions with complicated application procedures and limited assessment capacity, meant the SMEs found them difficult to access
5. The **(low) quality and “one size fits all” approach** for business development services meant that the private sector did not take advantage of them, though the current PSF model is working to address this constraint
6. The **general regulatory environment in Rwanda** is structured toward large companies that have the time and resources to comply, making the existing structures a challenge to grow for SMEs

7. **Inadequate Infrastructure for rural SME development** that inhibits implementation of innovative ideas and provision of services

From these previous challenges, it is clear that a focused coherent policy and integrated approach is necessary to create an enabling environment for SMEs. This will require a concerted effort to develop human capacity at the national and local level as well as the provision of adequate resources to support the implementation of the policy strategies. This policy aims to address these macro-level structural challenges which have characterized government interventions thus far while also taking into account the development goals of the Rwandan government, specifically to increase value-added processing to reduce the trade deficit and rise out of poverty and address challenges articulated by SMEs on the ground.

Government-supported SMEs financing facilities need to be consolidated in a fund that has the capacity to provide seamless service to access financing facilities. The regulatory environment must also include increased sensitization as well as significant changes to facilitate SME growth. Finally, it is imperative that all actors, from SMEs to government agencies, development partners and NGOs, be involved in the monitoring and implementation of the policy strategies in order to ensure quality assurance and maximize the benefits derived from the policy.

2.5 International Best Practices

Strengthening of the SME sector has been a successful tool in achieving economic goals in many countries. This section explores the experiences of:

- South Africa
- Tanzania
- New Zealand
- Malaysia

All of these countries governments have taken the lead in SME development to encourage economic growth. These SME policies and programs have been used in close conjunction with overall legislation and policy reform.

Each case study should be viewed within their unique context and each solution has been adapted to the specific country's needs, which has supported their success. In looking at programs and policy options to strengthen and expand the SME sector in Rwanda, the Policy identifies similarities, such as access to finance and capacity building programs, in the selected countries and adjusts proven programs to fit its specific needs as a bespoke policy solution.

2.5.1 South Africa: Youth Enterprise - Umsobomvu Youth Fund (UYF)

Since 1994, the promotion of SMEs has been a priority of the South African government. Its aim is to ensure that SMEs progressively increase their contribution to growth and performance of the South African economy in critical areas such as job creation, equity and access to markets. With a high unemployment rate (23% in 2007, 24.3% in 2009), and SMEs formally employing approx 50-60% of the labor force, investment in SMEs remains a high priority.

As a result of government backed dedicated SME strategies and policies, the number of SMEs operating in South Africa has increased from just over 1.2m in 2003 to 2.5m in 2009. The SME sector includes about 95% of all enterprises in South Africa (2003).

The Umsobomvu Youth Fund (UYF) was created in 2001 to facilitate and promote the creation of jobs and skills development among young South Africans. The UYF runs a number of schemes benefitting young people including the National Youth Service Program, Youth Advisory Centers – linking youth-owned SMEs to procurement opportunities and offering funding and loans to approximately 20,000 young people each year to start or expand businesses.

2.5.2 Tanzania: Women Entrepreneurship Development Program (WED)

In 1973, in recognition of the importance of small businesses in growing the economy, the Small Industries Development Organisation (SIDO) was created as a parastatal organization. By the mid-1980s, Tanzania had liberalized her economy and moved towards a market led economy. In 2002, the Small and Medium Enterprise Policy was introduced. However, a few years later, MSMEs were still facing problems such as an unsupportive legal and regulatory framework, ineffective marketing system, undeveloped value chains (characterized by low productivity level and low value-addition), and difficulties in accessing appropriate finances. In 2006, the Private Sector Competitiveness Project was introduced to reduce the cost of business and to address common problems affecting MSMEs, which account for over 80% of formal companies.

The Women Entrepreneurship Development Programme (WED) was formed in 2004 by UNIDO and SIDO in order to promote women's development and gender equality within the food processing industry. The scheme has experienced success and is currently operating in all 21 regions of Tanzania.

Training courses combine entrepreneurship and technical skills and by the end of the course, trainees are equipped to start their own food processing enterprises. There are 118 trainers working throughout the country: over 2,400 entrepreneurs have been trained, of whom 70% are in business, and 50% of those who have started a business are producing regularly. 1,700 jobs have been created by course participants, some of whom export to neighboring countries.

2.5.3 New Zealand: Business Mentors New Zealand (BMNZ)

In recent years policymakers and researchers in New Zealand have focused their attention on supporting SME growth. As a result, the Small Business Unit was established within the Ministry of Economic Development in 2003 and a Minister of Small Business was appointed, signaling the enormous importance of the sector.

In 1991, the Business Mentors (BMNZ) scheme was launched in New Zealand, based on the Business in the Community models of England and Europe. The concept is that large and successful businesses sponsor the development of small businesses. The BMNZ program is

funded by New Zealand Trade and Enterprise (30%) and by over 100 private sector companies (70%).

The scheme is available to businesses that have traded for at least six months with evidence of accounts, which employ fewer than 25 full time employees and where the business owner derives their main source of income from that business. Businesses are asked to pay a registration fee of \$100, thereafter any mentoring they receive is free and they may make use of it for up to two years. From the outset, BITC fulfilled a major need in this country to help small to medium sized businesses prosper and grow, and accordingly, create wealth and employment opportunities. Since 1991 over 50,000 small businesses have benefitted from mentoring services.

2.5.4 Malaysia: SME Corp

Prior to 2007, the Malaysian SME landscape was guided by two organizations: Small and Medium Industries Development Corporation (SMIDEC) charged with developing capable and resilient Malaysian SMEs and the National SME Development Council (NSDC) charged with coordinating tasks and making policy.

In 2009, the SME Corp Malaysia was established in order to coordinate SME programs across all related Agencies and Ministries and with formulating the overall policies and strategies for SMEs. SME Corp Malaysia is now the central point of reference for information and advisory services for all SMEs in Malaysia.

The remit of the organization is large and it provides the following services:

- Implementation of SME policies and programs
- Centre on advisory and information services
- Management of data, dissemination and research on SMEs
- Business support services

3.0 Vision and objectives

3.1 Vision

The vision of the policy is to create a critical mass of viable and dynamic SMEs significantly contributing to the national economic development

3.2 Mission

To stimulate growth of sustainable SMEs through enhanced business support service provision, access to finance and the creation of a conducive legal and institutional framework.

3.3 High Level Policy Objective

To foster job creation and an increase in the tax and export base through the promotion of competitive new and existing SMEs mainly in value added sectors.

In order to achieve this high level objective, the Rwanda SME policy will outline the following five policy objectives. The policy objectives address both the structural and resource challenges faced by previous government initiatives, as well as the challenges faced by SMEs and the ultimate policy objectives of the GoR. They are structured in their current order to take into account the process the GoR will undergo to become a better enabler of SME development and to mirror the needs of developing businesses from the inception of a business idea to the payment of taxes and compliance with regulation.

This structure ensures that the needs of all businesses are taken into account. It ensures start-ups can be sustainable and struggling SMEs find ways to grow. Start-ups receive particular support in this policy through entrepreneurship training and special start-up funding opportunities. Struggling SMEs will benefit from an improved and simplified regulatory environment and from the opportunity to work in clusters promoted in these policy objectives. Established SMEs on the other hand will reap particular benefits to expand their market by accessing market information and innovative technologies.

The key policy objectives are:

1. Promote a culture of entrepreneurship among Rwandans
2. Facilitate SME access to development services including:
 - 2.1 *Business development services*
 - 2.2 *Access to local, regional and international markets and market information*
 - 2.3 *Promote innovation and technological capacity of SMEs for competitiveness*
3. Put in place mechanisms for SMEs to access appropriate business financing
4. Simplify the fiscal and regulatory framework for SME growth
5. Develop an appropriate institutional framework for SME development

Although each of the policy objectives are essential to achieve the desired results, the strategies for the policy objectives will be implemented in phases to provide a scope for evaluating performance and “lessons learned” before full roll out takes place. A full implementation matrix is provided in Annex 1.

4.0 Analysis

4.1 Macroeconomic situation

In spite of the negative growth rate worldwide due to the recent financial crisis, Rwanda’s 2009 growth rate of 6.0%, (slowed from 11.6% in 2008)⁴, remains as evidence of Rwanda’s

⁴ NISR, March 2010 GDP release.

extraordinary economic development. In terms of government revenue, tax revenues increased by 10% in 2009 compared to the previous year, largely from the collection of Value Added Tax (VAT).

Inflation continued to fall from 22.3% at the end of 2008 to 5.7% at the end of 2009. Agricultural input, with the potential it brings in value-addition sectors, increased by 10% in 2009 due to the success of crop intensification programs.

This economic growth, increased agricultural production and reduced inflation show that Rwanda has the potential to enable a vibrant SME sector, with the ability to support the GoR through tax revenue and to take advantage of the trade benefits of the East African Community (EAC). In tandem with strong economic performance, the GoR has introduced a range of institutional changes and innovative policies to further support the business environment. In 2009, this was recognized by the IFC and Rwanda's "Doing Business" ranking improved from 117 to 67, the largest change for any country.

However, there are some economic indicators from 2009 that both underline the importance of developing a vibrant value-added SME sector while demonstrating the challenges that remain to its development. Export receipts in coffee, Rwanda's staple export, declined by 20%. This decline exposes Rwanda's vulnerability to export commodity shocks and hence the need to diversify and add value to the sector. Import prices also increased by 40%, with larger increases in key sectors such as cooking oils and fuel. There was also a 2% decline in lending by commercial banks in 2009 despite BNR mitigation measures.

4.2 Overview of the SME sector

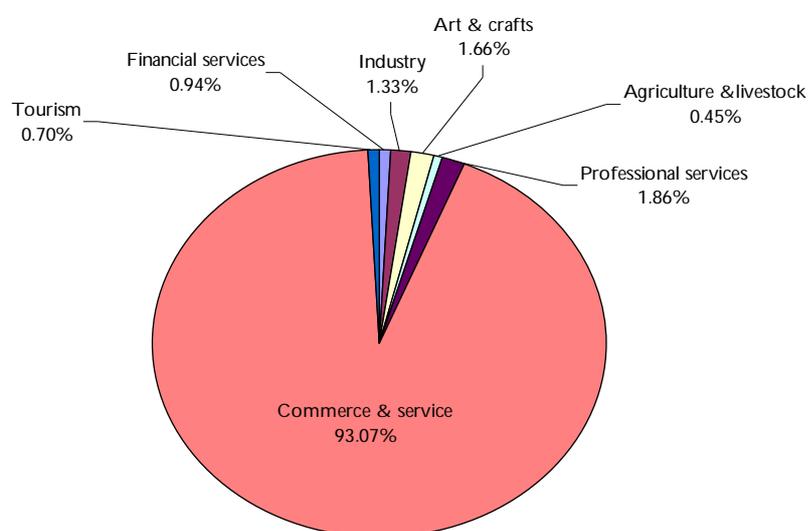
A 2008 PSF study estimated that there are over 72,000 SMEs operating in Rwanda, while only 25,000 of them are formally registered. This study found most small enterprises in Rwanda start off as micro businesses and grew into small businesses or they are formed to supplement the income of middle to upper income households.

Rwandan **small and micro businesses** comprise 97.8% of the private sector and account for 36% of private sector employment. They often lack proper accounting and financial systems.

Rwandan **medium sized enterprises**, by contrast, are well-established businesses that are individually or jointly owned. They have set administrative processes, qualified personnel and trained staff, employ between 50-100 people and account for 0.22% of businesses in Rwanda, contributing 5% of total private sector employment.

Combining these categories shows that SMEs comprise approximately 98% of the total businesses in Rwanda and account for 41% of all private sector employment.

Diagram 1: SME operators by sector



Source: Rwanda Business operators census report 2009

According to the EAC's report on SMEs in Rwanda, the vast majority of SMEs (93.07%) work in commerce and services.

This is followed by 1.86% in professional services, 1.66% in Arts & Crafts, 1.33% in industry, 0.94% in financial services, 0.7% in tourism and 0.45% in agriculture and livestock. This heavy concentration in the commerce and services sector, with only 1.33% in industry, reveals the need to address the challenges faced by SMEs, in order to build an economy based on value-added exports.

4.3 Key challenges to SMEs growth

SMEs in Rwanda face many macro-level challenges faced by large companies, including limited transport and energy, lack of a strong insurance industry, limited financial outreach, difficulties with contract enforcement and a weak education system. They also, according to the 2008 GTZ/PSF study 'Cutting Red Tape', face huge burdens in regulatory compliance costs that can be better absorbed by larger firms.

Unlike larger firms that may have the time and resources to invest in capital and human capacity building, SMEs often have limited abilities to develop the skills of their staff or to take advantage of local economies of scale in terms of energy, transport or raw materials.

They also often lack the ability to gather and process market information outside of what is immediately relevant to their current business due to lack of technical knowledge and training on how to make use of this information.

They are dependent upon a single individual or small group of individuals to develop business ideas and assume the risk of start-up or expansion and the burden of taxation and other regulations. This means that even for entrepreneurs that do see opportunities in the market, it is difficult to bring those ideas to fruition due to the potential costs of failure.

This challenge is exacerbated by the fact that financial institutions find it too high of a risk to lend to SMEs given the cost/benefit ratio in terms of time and resources required to process relatively smaller sized SME loans. This in addition to the difficulties most SMEs face in consolidating capital and creating business plans to become viable lending candidates. This creates a blockage to growth, where SMEs that have the skills to scale-up or move into manufacturing and processing cannot due to their limited access to finance.

A 2008 OTF/PSF survey identified the challenges faced by SMEs. The top challenge was high taxes, caused by the current tax regime. Next was the lack of customer/market knowledge, lack of capital, uncompetitive prices, access to finance and transport. The SME policy addresses all of these concerns with the exception of transport and uncompetitive pricing, as these are macro-issues related to import prices and infrastructure development. Further challenges are cited in the 2008 Capacity Needs Assessment of the SME sector, completed by PSF. These additional challenges include a lack of entrepreneurial culture and rudimentary production and limited access to appropriate technology in addition to re-enforcing the challenges stated in the OTF/PSF survey.

The key challenges to start-up/struggling and established SMEs are discussed here in the order of where they would impact the business cycle, thus connecting to the five key objectives outlined in this policy.

An analysis of the challenges to the development of a vibrant SME sector must go beyond the study of existing SMEs in Rwanda. While many of the challenges they cite are addressed in this and supporting policies, it is important to recognize that there are challenges to this sector that individual SMEs are not in a position to recognize or highlight. This is why the ultimate aims of the GoR, as well as key stakeholder analysis, are taken into account throughout this policy. In Rwanda only 1.33% of SME are engaged in industry, therefore the challenges they face in terms of access to technology and innovation will not feature prominently in surveys of SMEs, which are dominated by commerce and services. However, key stakeholder interviews and the explicit objective of the GoR to move toward value added processing to reverse the trade imbalance and reduce poverty focuses the policy on encouraging the SME sector to enter into industry and transforming the landscape of SMEs away from commerce and toward production. This goal means that access to technology is a key objective of this policy as it supports the GoR's vision for how the sector can contribute to its overarching goals. The same is also true of the lack of entrepreneurial culture. This would not be cited as a challenge in surveys of existing entrepreneurs, although it is discussed in such surveys as PSF's 2008 SME survey. If the GoR seeks to foster a shift to more innovative business, it is imperative that it encourages entrepreneurship.

Start Up

Lack of entrepreneurial culture

The unstructured environment in which SMEs operate and their inability to be open to new or innovative ideas presents a major challenge to the development of the SME sector. The 2008 PSF Capacity Needs Assessment of SMEs, which surveyed 2100 SMEs operating in Rwanda, indicated that the need for a greater entrepreneurial culture is a major priority for SMEs in terms of building human capacity and supporting potential growth. This was further re-

enforced by key stakeholder interviews. Stakeholders expressed the need to develop an entrepreneurial mindset in Rwandan educational institutions as well as the need to support existing entrepreneurs. Most SMEs duplicate business ideas until the market is saturated with copycat enterprises (mostly in trade or services), which also require lower input costs than value-addition activities, and are therefore lower risk. This means they are not taking advantage of potential business opportunities or even entering into business activities at all.

Limited technical and business skills

Many SMEs suffer from lack of technical and business skills. SMEs themselves identify a variety of skills gaps in areas including ICT, technical and industrial knowledge, finance, accounting and management. Many SMEs have rudimentary production facilities, low quality products and underutilize appropriate technologies. There is also limited innovation and competitiveness in the SME sector caused by a lack of technical and managerial skill.

Limited Business Development Services (BDS)

SMEs face a lack of good quality business development services tailored to their needs. PSF's efforts thus far have been forced to scale back due to resource and capacity constraints, meaning many businesses have not received the skills they need to succeed. Studies indicate that while many institutions exist to provide BDS services, the quality of these services varies greatly, making SMEs wary of taking advantage of them. Furthermore, the previous lack of private sector involvement means that the private sector does not need to commit to these services and interventions may be inappropriate to the needs of SMEs.

Scale Up

High cost of doing business

The high cost of doing business is cited by SME owners as one of the biggest challenges. This is in terms of high energy and transport costs. In addition, SMEs in Rwanda face significant compliance burdens dealing with existing regulation. The current tax regime is both costly and difficult to comprehend. The 2008 GTZ/PSF study 'Cutting Red Tape' cites regulatory compliance as a major block to all businesses in Rwanda, with over 40% of spontaneous responses stating that regulatory compliance was a key constraint to business growth. This study estimates that the regulatory burden faced by business amounts to 3% of Rwanda's GDP annually. This burden is a particular challenge to SMEs with fewer, less specialized staff than large firms as these companies often must have managers or bookkeepers dealing with compliance instead of performing their regular work.

Lack of access to finance

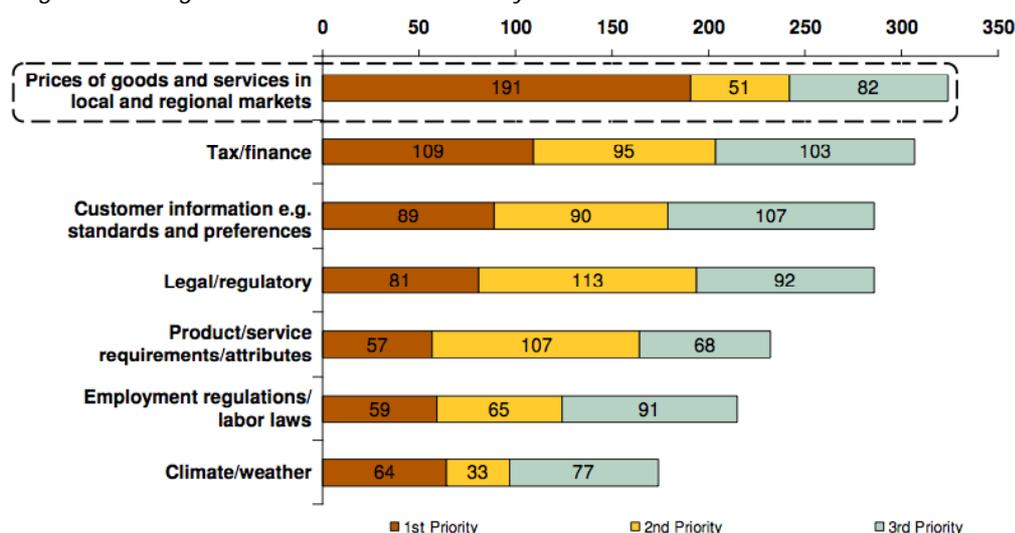
SMEs lack access to financial services. As evidenced by the OTF/PSF survey, financial institutions perceive SMEs as high risk and are therefore inflexible in terms of collateral and repayment terms. This is compounded by the fact that most small borrowers lack experience and understanding of financial organizations and do not have the necessary technical skills to make successful applications.

In addition, most financial products from commercial banks are not suitable to the agricultural sector, where most SMEs currently operate, and existing regulations limit the total funds available for lending.

Difficulty accessing market information and markets

SMEs face difficulties accessing and utilizing information regarding local, regional and international pricing, a major constraint to business planning as well as about the regulatory environment in Rwanda and regionally. Among SMEs there is poor participation in the policy-making process, meaning they have little knowledge of interventions designed to assist them. SMEs have inadequate access to market information that could benefit their businesses as well as inadequate knowledge about marketing their products both nationally and internationally.

Diagram 2: Categories of information needed by SMEs



Source: BDS strategy initial analysis - OTF Group, 2008

These challenges and constraints to the development of a vibrant SME sector have a far-reaching impact on Rwanda's economic development. As outlined above, they stifle the SME sector from the stage of start-up companies, which need skilled entrepreneurs open to innovative thinking, to existing companies that are unable to scale up or expand into value addition sectors.

Building an entrepreneurial mindset, developing a skilled population, creating an enabling regulatory environment and giving access to finance and targeted opportunities and incentives, will support the development of a business cycle, from start-up to scale-up, and will benefit all entrepreneurs, ultimately contributing to achieving Rwanda's development goals.

The GoR has attempted to address several of these challenges, especially regarding finance and training. However, according to stakeholders and secondary source materials from PSF, the EAC, OTF, GTZ and the World Bank, many of these attempts have not yielded the desired results due to an absence of a dedicated SME policy, complicated procedures to access funds (i.e. government financing facility), limited awareness among the SMEs regarding service availability (i.e. scattered funds in four different agencies – BRD, BNR, RDB, MINICOM), lack of coordination between and within agencies, isolated interventions, capacity shortages among service providers and inadequate resources (i.e. BDS centers).

The focus of this policy is therefore on consolidation and coordination of resources and programs as well as engagement and communication with the private sector in order to redress the past challenges. The private sector must play a dominant role in the implementation of the policy, with government in a supporting role, providing an enabling environment that encourages development of the SME sector.

5.0 Preferred policy objectives

Evident in best practice policies and “lessons learned” in Africa, Australasia and Europe, a number of clear factors are required in order to enable success. These factors include:

- Support and incentives for new activities that are **time-bound**
- Clear **benchmarks** provided to measure success over time
- Active **monitoring** and evaluation of performance
- Sustained **dialogue** with the private sector
- High-level **political oversight and ownership** of the policy implementation process

For each policy objective, policy choices are evaluated on their **suitability** to achieve the objectives of the policy, their **feasibility** in being delivered with the systems and finance available, and their **acceptability** among stakeholders.

5.1 Policy objective 1: *Promote a culture of entrepreneurship among Rwandans*

Challenge addressed: Lack of entrepreneurial culture and mindset in business environments

Entrepreneurial culture is underdeveloped among Rwandans given the short history of business in the country and the absence of successful role models. Many Rwandans will not become entrepreneurs, but will contribute to the growth of business as skilled employees. Skills development, as well as the promotion of entrepreneurship for those in programs that display entrepreneurial motivation, are already being addressed by TVET and PSF initiatives. However, as identified by the PSF capacity needs assessment, promoting a culture where those with the desire and energy to become entrepreneurs are nurtured and encouraged is integral to growth of the SME sector.

Whilst entrepreneurship has been introduced into the curriculum of numerous institutions, there is often not yet a practical element. By offering practical opportunities for young people interested in business to engage in entrepreneurship, they are more likely to engage in entrepreneurial activities.

Strategies

A number of key policy strategies are required to achieve the aim of this policy objective. They will be executed in collaboration with Ministry of Education (MINEDUC) and the Workforce Development Authority (WDA).

- Introduce a component of entrepreneurship training into school and TVET curriculums, both focusing on risk and innovation and also business skills such as financial management and marketing
- Introduce a youth entrepreneurship course for existing associations of out-of-school or vulnerable youth interested in starting their own business; the course would include training in business skills such as financial management, marketing, risk and innovation; this would be funded by the capacity building component of the SME fund
- Establish a national Young Enterprise Scheme with annual competitions; this is a nation-wide program that offers teams of young people over the age of 14 (in selected educational institutions) the opportunity to run a business for an academic year; teams select a board of directors; choose a product or service; market and sell their product; manage the company and gain real experience of running a business; they are mentored by a local businessman and at the end of the project are entered into a national competition, the winner receiving the “Young Enterprise of the Year Award”
- Implement a mentoring program for young people starting businesses via the BDS centers; leaders of local successful businesses should be recruited and trained in how to offer advice to young people
- Identify successful entrepreneurs who would act as ambassadors to young people; these ambassadors would be required to make at least 4 appearances per year in their district to groups of young people
- Introduce talks on business related topics and visits by leaders in government and private sector targeting children from their early age, i.e. pre-primary and primary school

5.2 Policy objective 2: *Facilitate SMEs access to business development services*

Challenges addressed: Lack of management and technical skills, lack of access to market information and markets, high cost of doing business, limited BDS services

The policy objective to facilitate access to business development services has 3 components, each of which contributes to improving services and providing capacity building support for SMEs.

5.2.1: Business Development Services

Business Development Service (BDS) Centers were first introduced in 2006 to address SME capacity and access issues and to decentralize services across the country. However, the BDS centers have been met with varied success. The BDS centers were restructured and re-launched in February 2010 as a private/private partnership sponsored by PSF/RDB and local government. There are currently 22 centers throughout Rwanda operated by trained and selected independent BDS advisors, working as paid consultants, and BDS staff. This program is currently too new to be thoroughly evaluated. This policy proposes to use this recent rollout as a pilot to inform future strategy direction.

Offering a mixture of private and public services should be the recommended model for the provision of BDS services. The model takes into consideration the results of the 2008 PSF/OTF survey in which 48% of SMEs said they would pay for BDS services. This is especially noteworthy given the challenges BDSs have faced thus far and the size (72000) of the SME sector.

People place a higher value on services they must pay for themselves, meaning the program would be self-evaluating as poor service providers will not be contracted. However, many micro and small companies would not be able to afford market rates, and would require some free or at least subsidized services. Subsidies for services would come from the capacity building element of the SME development fund, discussed later in the policy as well as by certifying NGO/development partner staff working for existing subsidized programs. Working with the over 2,000 public and private business support projects in the country will vastly enhance the impact of BDS services. The GoR could also provide small incentives to business consultants, via the national treasury, for each client assisted. The centers could also analyze a business model based on a “no win, no fee” basis for SMEs. For instance, BDSs can provide inputs to prepare a loan application including developing a business plan for SMEs, but would only charge fee/commission for such services if the loan is eventually approved by the bank.

Strategies

A number of strategies are required to achieve the aim of this component.

- Establish operational BDS centers in targeted high-impact areas with at least two staff members, in collaboration with other key stakeholders who want to offer their services; the services they provide should include
 - Access to finance training
 - Market information
 - Access to IT
 - Business advisory clinics
 - Training on bookkeeping

- Advice for completing tax return
 - Database of approved consultants
 - Tax advisory services
 - eGovernment portal for government services to the citizenry
- Using a PPP approach, establish 12 Centers of Excellence offering full scale BDS services and SME business incubators, specifically targeted at the development of key value-added clusters
 - Each BDS center, through the collaboration of staff and advisors, will identify at least three priority clusters in their area to target for full value-chain development
 - Train a critical mass of private Business Advisors in every sector, drawing from existing training institutions (NGOs and private sector) as well as independent consultants, in offering specific components of BDS services such as access to finance, market information, bookkeeping etc;
 - Certification by the RDB: Upon completion of training, advisors would be awarded a certificate in the specified component and referred to a BDS center from which they operate; this will improve out-reach of BDS services on a sustainable basis. The business advisors could be rewarded through small allowances (from the BDS budget) for mentoring successful businesses on top of fee based services such as accounting and tax advisory services.
 - Design and implement a training program for BDS center staff and consultants to identify the challenges faced by struggling businesses to determine whether they are viable and what inputs are necessary to support those that are
 - Each BDS should establish a database of qualified and quality business advisors, in specialized service areas, to be recommended to SMEs; for a consultant or partner to be added to the database of approved consultants, BDS staff should conduct a quality assessment; this could include feedback from SMEs that have used their services; other criteria for being added to the database could include professional qualifications and previous experience of working with SMEs
 - Analyze the feasibility of “no win, no fee” business model
 - Introduce a “business reward scheme” for BDS staff members for increasing the revenue of SMEs that accesses services from their respective centers; the criteria and level of incentives of such a scheme will need to be developed
 - Conduct mobile business road shows to popularize SME use of business development support services

5.2.2: Access to local, regional and international markets and market information

SMEs in Rwanda lack an understanding of the local, regional and international market in which they operate, limiting their ability to take advantage of potential market opportunities. They do not have the resources or time to spend gathering and understanding market information that would be useful to their operations. This inhibits SME innovation and growth. Locally this leads to heavy duplication of business ideas. Consequently, competition stifles the sector instead of leading to diversification and innovation. This means that SMEs are unable to compete with larger businesses that have the time and resources to devote to market research. In addition, GoR procurement procedures favor larger businesses and are limited to registered companies that automatically exclude the majority of SMEs.

Strategies

A number of key policy strategies are required to achieve this component.

- In each district with a BDS, develop a strategy on how to network with SMEs to determine their changing market information needs and how to best create tools for them to access this information
- Comprehensive databases of market information to be made available at BDS centers for SMEs
- Facilitate participation of SMEs in International Fairs and in Trade Missions
- Develop and implement a program on preferential access by SMEs to GoR procurement contracts

5.2.3: Promote innovation and technical capacity of SMEs for competitiveness

International experience, as well as examples from the Rwandan context, have shown the positive impact appropriate technologies and infrastructural developments can have on the SME sector and especially manufacturing and start-ups. However, Rwandan SMEs currently face a range of challenges to effectively integrating these technologies. The fact that the sector is predominantly informal and lacks access to finance is a major challenge to the use of technologies.

Many SMEs also lack the technical and analytical skills to effectively use these technologies or to interpret ideas arising from government research initiatives. There is a need to harness the power of technology transfer to build capacity and spur entrepreneurship within the SME sector.

Strategies

A number of key strategies are required in order to achieve this component:

- Promote creativity and innovation in the SME sector through the establishment of annual award schemes that recognize innovation and technology development
- Through BDS centers, facilitate links between research institutions and SMEs to commercialize research products, focusing on targeted clusters along the value chain—including agricultural research for agro-business, product development and eco-technology in tourism etc.
- Using mobile ICT vans, increase the adoption of appropriate and useful ICT into SME business practices
- Introduce regular IT training for SMEs and make available subsidized business software loaded laptops for attendees
- In collaboration with private sector real estate developers, establish regional industrial parks in four provinces to provide necessary basic infrastructure for SMEs clustered in manufacturing and services
- Introduce appropriate technology demonstration centers, in partnership with SMEs, within the industrial parks for practical training and acquisition of technologies for value-addition
- Provide access for SMEs to the Special Economic Zones (SEZ) for facilitating technology transfer and technology diffusion among the operating firms the assumption being having access to adequate infrastructural facilities and working alongside other large and small enterprises will promote technological adoption.

5.3 Policy objective 3: *Put in place mechanisms for SMEs to access appropriate business financing*

Challenge addressed: Lack of access to finance

Access to business finance

Lack of access to finance is frequently cited as one of the biggest challenges for SMEs. In comparison, lending institutions cite the lack of viable projects and their own capacity constraints to assess loans as the barrier to lending to SMEs.

Financial institutions perceive SMEs as high risk and are therefore inflexible in terms of collateral accepted and repayment terms. This is compounded by the fact that most small borrowers lack experience and understanding of financial organizations and do not have the necessary skills to make successful applications. In addition, most financial products from

commercial banks are not suitable to the agricultural sector, where most SMEs currently operate, and existing regulations limit the total funds available for lending.

The policy recommends working with private commercial banks to strengthen their SME lending windows and knowledge of SME's in general.

Despite this, there are funds available for SMEs to assist in lending. Currently there are four credit lines and four guarantee funds created by GoR for which SMEs are eligible. These include funds for export promotion, agricultural development and SME development. They are managed by two different entities: the National Bank of Rwanda (BNR) and the Rwandan Development Bank (BRD). However, this poses two problems: firstly the complexity of having a number of different funds managed by different entities; and secondly the issue of "conflict of interest", when the facility is managed by an institution that is the biggest recipient of the fund itself (i.e. currently BRD).

The tables below illustrate the current funds available and their utilization rates.

GoR Credit lines

Facility	Fund Manager	Size (million RwF)	Utilization	Utilization rate
RIF II	BNR	5,517.9	145.7	3%
Retrenched Civil servants	BNR	1,050.0	2,005.5	191%
Export Promotion Fund	BRD	5,368.2	5,368.2	100%
MFI credit line	BRD	-	-	-

GoR Guarantee funds

Facility	Fund Manager	Size (million RwF)	Limit	Utilization	Utilization rate
AGF	BNR	1,836.2	7,344.7	10,247.8	140%
WGF	BNR	255.2	1,020.7	370.4	36%
Retrenched servants	BNR	200.0	800.0	1,034.5	129%
SME Guarantee Fund	BRD	2,072.9	8,291.6	109.1	1.3%

The utilization rate for most funds is high and often exceeds the funds available; however, for others the utilization rate is very low. In particular, the utilization rate of the SME guarantee fund is staggeringly low at 1.3%. Reasons for the under-utilization of the SME guarantee fund is put down to the complication of preparing the application, cost of accessing the guarantee (including commissions) when there is a cost free guarantee fund available elsewhere notably the agricultural guarantee fund. Harmonization of the management of these funds will resolve the issue.

A key factor for low utilization rate is that the smaller organizations simply do not have the capacity to go through the complicated application procedures and in some cases they are not aware of the existence of such facilities. Putting various funds under one umbrella is likely to improve this situation and it would be easier to evaluate the success of a dedicated fund when they are running in co-ordination with each other rather than in isolation under separate agencies. Guarantee funds are necessary to increase commercial bank loans to the SME sector and lower interest rates.

Policy choices

Focus will be put on removing constraints that prevent SMEs from accessing finance, including resolving the capacity problem, addressing organizational issues in cooperatives, influencing change in attitude of banks and micro-finance institutions, etc.

An SME Fund will be put in place in response to gaps in the market. There is a need to consolidate all scattered SME support funds into one SME Development Fund. The procedures and processes involved in disbursement also need to be revised to make it easier for SMEs to access funds. This will not only resolve the issue of complication in accessing the fund since the fund will operate under a “one stop shop” management mechanism but a more focused integrated approach would also be built with trained specialized experts and clear, harmonized screening, approving, disbursement and monitoring procedures.

Three policy options are presented for the future management of the SME development fund.

Options	Management of SME Development Fund under a new SME Development Corporation	Management of SME Development Fund under a BRD subsidiary	Management of SME Development Fund under REIC
Suitability	Medium Independence from the banks distributing the fund will bolster commercial banks confidence and therefore use of fund. Integration of roles between building capacity and disbursing funds to SMEs will reduce complication and increase utilization rate. Would also improve communication and marketing to SMEs and banks.	High The Bank – BRD has the largest number of clients who benefit from guarantee facilities, with BRD subsidiary managing the fund it would leverage their SME lending experience.	Medium REIC already has a mandate to provide improving financing access to SMEs But is in a weak position and would require heavy restructuring to handle extra mandate.
Feasibility	Low Investment required in infrastructure and capacity building for new staff and sensitization to SME lenders, would be high.	High Leveraging BRD existing infrastructure and expertise would reduce the new subsidiary costs. However investment in capacity building and sensitization to SME lenders will high in the beginning.	Medium Heavy Investment required in capacity building for new staff and sensitization to SME lenders.
Acceptability	Low Agency will have a focused approach to SME development including capacity building for staff and SMEs to enable SMEs to use	Medium There is a risk that the mindset of the bank and disbursement procedures remain the same meaning continued low utilization. Commercial banks have	Medium Company will have a focused approach to SME development including use of the funds profitably. This is highly accepted by stakeholders. Banks would apply for guarantees on behalf of clients much as company can refer

	the funds profitably. Banks would apply for guarantees on behalf of clients much as agency can refer SMEs to banks for guaranteed loans. Opening up new agencies is least desired by most Government departments consulted	raised issues of conflict of interest since the fund would be managed by a BRD subsidiary. Giving the subsidiary an independent and inclusive Board of Directors will mitigate this risk	SMEs to banks for guaranteed loans
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Recommended option

Considering the current mandate and institutional framework that focuses on SME promotion in Rwanda, **the BRD Subsidiary with financial and administrative autonomy supported by a strong board of directors drawn from public and private sector is the preferred company to manage the fund under a Government contract, while devising a mechanism to minimize the conflict of interest feared by other banks. Independence from the banks distributing the fund will also bolster commercial banks confidence and therefore use of the fund.** The proposed REIC could also be another candidate for fund management responsibility but this would require more investment in administrative infrastructural facilities and human resources compared to an existing company (BRD subsidiary which could be opened up to other shareholders as well).

Strategies

A number of key policy strategies are required to achieve the aim of this policy objective. These strategies can be adapted to whichever policy option is chosen for the above.

- Consolidate all existing funds available to SMEs under the chosen body to facilitate SME access to finance at conditions tailored to stimulate manufacturing, growth and competitiveness. These special conditions concern the interest rates, the maturity of loans, and the requirements of collateral; mechanisms for channeling funds to SMEs, through one single source can prove efficient, quick, and cost effective; the revenue generated from the fund (through fees, equity participation) should also be used for equity investment in potentially successful SME projects
- Strengthen the governance of the BRD subsidiary managing the SME development fund with a Board of Directors drawn from public sector and private sector including the bankers association.
- Scale up government loan facilities to include different components which will assist SMEs in all stages of the business cycle; **the new components proposed are:**
 - Credit line – Recommending credit to assessed SMEs through partner banks
 - Guarantee fund – underwriting loans to SMEs by financial institutions
 - Capacity building fund – to assist SMEs with access to technical assistance that can be used to enhance SME capacity; a portion of the SME development fund will mainly be dedicated to enterprise development and innovation programs
 - Innovation fund – for research and development, market research, ICT and technology advancement

- Matching grants – matching enterprise equity injections into viable SME projects
- Establish Enterprise Investment Scheme for private/public investors (both individuals and institutions) for equity participation in viable SME projects
- Given the importance and share of the agricultural sector for SMEs, the fund could also have a special subcomponent dedicated to agricultural financing
- Promote a warehouse receipt system as an alternative form of collateral for SMEs, in essence collateralizing their agricultural products
- Over and above the SME development fund which may not sufficiently cover all SME financing needs, work with all commercial banks to introduce SME windows and mobilize additional resources for SME lending
- Work with commercial banks to simplify lending procedures to SME's taking advantage of the new mortgage law that simplifies collateral.

5.4 Policy Objective 4: *Simplify the fiscal and regulatory framework for SMEs growth*

Challenge addressed: High cost of doing business
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The promotion of a legal and regulatory framework, that supports the development of SMEs, is key to both promoting and formalizing the sector. Current Rwandan investment and tax policy is structured toward the promotion of large enterprises and also fails to take advantage of the huge tax potential of an SME base that is willing to comply with simplified procedures and tax rates that stimulate rather than stifle entrepreneurial thinking.

In Rwanda both the high rate of taxation and the complexity of the tax code are major burdens to SMEs. Businesses in Rwanda must currently pay under a minimum of seven separate tax regimes, meaning not only is taxation high, but the World Bank estimate 3% of Rwanda's GDP is spent on compliance issues (Red Tape Study, 2008). This goes beyond taxation to include environmental regulations, EAC and international quality and safety standards required for export and Rwandan government health protocols. Many SMEs in Rwanda are shut down due to failure to comply with environmental or health regulations, even though they cannot afford to comply or do not understand the regulations themselves.

The GoR recognizes the need to simplify the complex systems and to reduce the rate of tax in order to encourage unregistered businesses to enter the tax system. In line with this, a move towards a Flat Tax (FT) regime in Rwanda is currently being discussed. The aim of a FT will be to reduce the administrative burden on all economic agents, expand the available tax base through formalization and thus increase revenue generation. Experience in other countries has shown that lowering taxes can actually increase tax revenue by improving tax compliance and increasing the tax base. The South African Revenue Service has increased its revenue by

an average of 17% a year while continuously introducing incentives such as the consolidated turnover tax, to reduce taxes for individual SMEs⁵.

The implementation of a flat tax encompassing income, VAT, employment and profit taxes is already in the process of being studied and developed. Special attention is being paid to the possible impact on SMEs, particularly around the proposed removal of all exemptions, incentives and special conditions. A flat tax should maximize government tax revenue collection while keeping rates low enough to allow tax payers an acceptable return for their effort and entrepreneurship. It is assumed that the flat tax will be introduced for all businesses in Rwanda.

Strategies

A number of key strategies are required in order to achieve this policy objective:

- Simplify tax procedures for SMEs filing returns by reducing the number of payments to two per year and the number of taxes to be paid to one single authority as opposed to the current situation
- Undertake a publicity campaign to inform SMEs of the new FT regime and benefits of formally registering as a tax payer
- Sensitize SMEs to new regulations to increase formalization
- Adopt a non-retroactive payment policy (don't ask) for newly formally registered SMEs
- Introduce a reward scheme for registered SMEs that induce un-registered SMEs to register for tax purposes
- Work with regulatory agencies to simplify and streamline regulations for SMEs, making them SME friendly
- Provide financial support through the SME development fund to assist existing viable SMEs that face closure for non-compliance
- Through the BDS, sensitize and train SMEs on environmental protocol, RBS standards and health regulations, especially within the manufacturing industry, enabling SMEs to assess their own businesses
- Establish a scheme in RBS to accompany targeted SME clusters to meet standards
- With REMA, develop training programs on environmental assessments and standards in order to disseminate this information through BDS centers

⁵ South African Annual Revenue Service Annual Report, 2008

5.5 Policy Objective 5: *Develop an appropriate institutional framework for SMEs development*

Challenge addressed:

Lack of resources, coordination and capacity, at an institutional level, for previous SME initiatives

Currently, the SME landscape in Rwanda is scattered with institutions offering services to SMEs. However, there is no institution fully dedicated to SMEs nor is there one body responsible for overseeing a comprehensive SME intervention. The key players currently are: MINICOM, RDB, Rwanda Enterprise Investment Company (REIC) and PSF.

In order for the GoR to succeed in its aim to prioritize SME development, and therefore increase the capacity of the private sector and meet its ambitious development goals, a clear institutional framework for SMEs needs to be developed. Responsibility for implementing the SME policy will be handled at the agency level, while MINICOM remains in charge of policy oversight. After careful analysis and consultation with stakeholders the following **three policy options have been developed**.

1. **An existing institution that has the potential to fulfill this role is the Rwanda Development Board (RDB). The current mandate of RDB includes support to the development of SMEs in Rwanda. This means that RDB is well placed to develop the capacity and the structures to operationalise the non financial components of the SME development policy. RDB would ultimately be responsible for the implementation of all the strategies outlined in this policy, in close collaboration with existing institutions, such as PSF, RCA, and private sector actors. This includes the administration of capacity building initiatives through BDS centers, as well as collaboration with other government actors on entrepreneurship development, market and technology research and implementation and the creation of an enabling regulatory framework. To support full implementation of the policy actions, the BRD subsidiary recommended under 5.3 above would manage the SME development fund with the component on SME capacity building funding SME capacity building activities championed by RDB and PSF.**
2. A second alternative would be to give the responsibility for the policy implementation to the restructured REIC. The REIC would be responsible for the management of the SME development fund, as well as the implementation of the capacity building components of the policy and other policy objectives.
3. The final option would be establishing a new SME Development Corporation with financial and administrative autonomy to be able to attract private investment. This new agency would lead the SME development policy implementation process, combining capacity building initiatives and management of the SME development fund. Although Initially it will receive seed financing from government, the corporation

would be self-sustaining through SME management fund fees, other fee-based services and other revenue generating activities. Although funding constraints, and a move away from the creation of more government-backed institutions is a concern, this is mitigated by the political will to effectively implement strategies to create an enabling environment for SMEs and the potential for international development partners to invest in the new corporation. A number of countries in Asia that have a well developed SME landscape have had such dedicated SME agencies.

Recommended option

From the options presented above, and following a lengthy consultative process **the first option of sharing the responsibility for SME policy implementation between the BRD Subsidiary and RDB will best position this policy for successful implementation of the SME development strategies.** The BRD subsidiary can be turned into a vital institution that focuses on SME financial instruments, managing the SME development fund products and attracting additional funding from interested partners.

During policy consultation a concern was raised that this being a BRD subsidiary would create resistance from other banks fearing conflict of interest. To mitigate this risk, giving the entity autonomy, a strong board of directors drawn from the private and public sector would maintain stakeholder confidence.

Strategies

A number of key strategies⁶ are required in order to achieve this policy objective. Although they are described here with REIC and RDB as the preferred option, they can be adapted to whichever option is chosen:

- Strengthen the governance of the BRD subsidiary with a strong Board of Directors drawn from public and private sector including the bankers association.
- Prepare a financial sustainability strategy so that the company can generate its own revenue from the fees from management of the financing facilities
- Assess the existing structure of the subsidiary and open up partnership opportunities for a broader group of stakeholders including commercial banks and other corporate entities
- Mobilize funding following a clearly articulated “Fund Raising Strategy” from the existing partners and donors including the World Bank (WB), Department for International Development (DFID – through their recent Access to Finance Project) African Development Bank (AfDB), European Investment Bank, Japanese International Cooperation Agency (JICA) and IFAD among others who have already shown keen interest in expanding the SME sector in Rwanda

^{6 6} *Some of the strategies are short-term, others medium and long term strategies addressing the challenges faced by SMEs*

- Strengthen equity investments in new SME ventures
- Build and strengthen the overall capacity of BRD subsidiary to screen, evaluate and monitor business plans of start-up and established SMEs to encourage private equity investments (from individuals and institutions) and improve bank financing opportunities
- Recruit and train staff capable of managing the organization and fulfilling its mandate
- Assess RDB current cluster based structure and reconfigure for execution of the other SME policy objectives (apart from Managing the SME development fund) considering that SME support is found to be cross cutting in the current RDB structure.

6.0 Stakeholder views

This policy is based on evidence on the ground. A High Level Technical Committee set up by MINICOM to assess the progress and quality assurance provided substantial inputs into the formulation of this policy.

Representatives of all stakeholder groups involved in the policy were consulted during the policy process. This included financial institutions, government bodies, SMEs, consultancy firms working with SMEs and development partners. The input from these consultations is incorporated throughout the proposed policy options. A summary of their specific feedback is provided here:

6.1 Government bodies

Government bodies recognized the importance of supporting SMEs for economic growth. However, they cited many challenges with current structures. Sometimes diverging opinions were registered over the institution suitable to implement the policy and the placement of the SME development fund. These positions were captured in this report in a balanced way for the Cabinet to take a final decision.

6.2 Banks

Commercial banks cited their own capacity challenges as well as those of prospective clients as major constraints to SME lending. They felt that their own staff were not well trained in risk and loan assessment, relying too much on personal connections and collateral as primary assessment tools. They also felt their clients were not well enough educated on the concept of lending. They were concerned with a perceived 'default' culture in Rwanda, meaning that many loans are not repaid under commercial and government lending schemes.

They cited their own existing staff and client training programs as possible best-practice, but felt larger initiatives must be taken to improve the lending environment overall.

6.3 SMEs consultancy firms/development partners

Consultancy firms and development partners working with SMEs cited several major challenges, both environmental and institutional. They also saw large coordination failures between NGO/private and government actors working on capacity building for SMEs. Consultancy firms/development partners mentioned general lack of technical and market skills within the SME sector. They recommended a single coordinating body for SME development as a catalyst for program coordination and donor resources and also to deal with communication issues within the sector. Other challenges cited for SMEs were access to markets. It was highlighted that small businesses often have difficulty accessing larger contracts because they don't have the network or contacts that other larger companies might have. They also were very positive about the individual entrepreneurs with whom they had interacted.

6.4 SMEs

SMEs cited the challenges reviewed above in the analysis section. In stakeholder interviews, many businesses cited lack of customers as a key problem. The scenario of new businesses copying existing business models and opening in the same area is a problem because it causes a saturation of the market. High costs, in terms of rent and transport were also referred to frequently.

There were specific complaints about government agencies dealing with SMEs—from the RRA and REMA to the Rwanda Bureau of Standards (RBS) and the Rwanda Cooperative Agency (RCA). Complaints related to the difficulty understanding the Rwandan tax code, environmental regulations and health regulations were common as well as frustration with the RCA in terms of the timeliness of cooperative registration.

Business training is a need, but often business owners were not aware of what support is available or where they would access it. SMEs cited that they would like access to targeted, high quality training, but it would be difficult to find the time to attend. They mentioned that often they did not have the tools to implement what they had learned from training programs in their daily business. SMEs also felt that only existing larger entities could move into value-added sectors, given the barriers to entry regarding finance and technical capacity.

Young entrepreneurs explained the difficulties faced when trying to access finance. They feel they are not taken seriously by banks because of their age and perceived experience. They also cited protection of ideas as a problem. Several examples of business plans being submitted, refused and then stolen and used by others were given. This is clearly a problem, as it shows resistance to accepting success by young people and a need to build capacity among those assessing funding applications.

7.0 Implementation plan

Annexed to the SME policy is a detailed implementation plan with indicators for monitoring and budget that covers the policy objectives, the policy choices, the strategies to achieve the policy objectives, the timeframe and the responsible implementing agencies for accountability purposes. Key GoR implementation bodies include RDB, BRD subsidiary, MINECOFIN, BNR, and PSF while MINICOM will be in charge of the oversight of the implementation of this policy. The private sector, including banks, must play a dominant role in implementation, with government in a supporting role to ensure an enabling environment that encourages development of the SME sector.

8.0 Financial implications

The financial implications of this policy have been carefully reviewed and the total budget for the implementation of this policy has been costed. The details are enclosed in the implementation plan.

9.0 Legal implications

The legal implications of this policy are mostly contingent on the decisions to be made regarding the proposed changes to the tax regime for SMEs. There will also be legal considerations in respect of the set up of a new agency (should it be a recommended option) and of the consolidation of the new SME development fund.

10.0 Impact on business

Business is the focal point of the policy. The policy aims to increase the number of viable SMEs who become formalized and contribute to the growth of the country's economy. With the growth of the SME sector, business as a whole will benefit from increased coordination and capacity building.

The strategies within this policy will be piloted and evaluated before full implementation in order to determine their potential impact and amend them for maximum efficacy.

The private sector has been widely and regularly consulted during the policy formulation and will be during policy implementation. This consultation and feedback is particularly important where businesses are engaged in innovative and new activities. In this process, SMEs will have intensive support from the GoR, although incentives will be time-bound.

11.0 Impact on equality, unity and reconciliation

The four principal crosscutting areas relevant to the SME policy are: gender, youth, ICT and environment. They have the potential to deeply impact the success or failure of the policy.

Gender and youth are imperative to the growth of SMEs in Rwanda due to both the sheer size of these population groups and the untapped potential they hold as entrepreneurs.

Rwanda has made great strides to promoting both, however many within them remain marginalized. Therefore, specialized support to these groups is incorporated throughout the policy.

ICT and environment are equally important to the long-term sustainability of SME growth. ICT is necessary to building a modern economy that is able to compete in an increasingly globalized world. The case of South East Asia shows how rural agricultural economies can transform themselves and rise out of poverty through the use of technology.

Environmental protection is especially important in Rwanda given the size of the country and the need to protect and utilize land and waterways. Although business growth can often conflict with environmental protection, building bridges between environmental authorities from the outset can mitigate challenges that arise.

12.0 Handling plan (communication plan)

Once the SME policy has been adopted, dissemination to SMEs and stakeholders should occur. If the preferred option of the institutional framework, a separate agency, is accepted, this agency will become the key body for overseeing implementation of the SME policy.

After the policy is finalized, there will still be an important role for extensive, regular, themed consultation forums for the discussion of the SME policy implementation.