Invitation for Proposals
Preliminary research on financing structures to promotes SMEs' access to finance and business development services

Qualified and experienced consultant(s) are invited by the Swiss Agency for Development and Cooperation (SDC) in Nepal to submit a proposal to conduct an in-depth research into potential financing and partnership structures and to recommend the most suitable set of models which will contribute to the development of a model that promotes SMEs' access to finance and business development services.

Terms of Reference

1. Background

a. Context

Small and Medium Enterprises (SMEs) drive innovation, create employment, and even have the potential to address social challenges and help reduce poverty. In Nepal, SMEs account for almost 25% of the Gross Domestic Product and employ about 1.7 million people.[1] However, despite the significant potential for high growth across multiple sectors, SMEs in Nepal have only witnessed modest growth over the years. While Nepal's best ever ranking on the Ease of Doing Business in 2020 (94th out of 190 economies) has created a positive momentum, it still lags behind its regional neighbours such as India and Bhutan, in terms of creating framework conditions that help enterprises to thrive.[2] Nepal's enterprise ecosystem is characterized by inadequate, and at times unsupportive regulations and a general misconception that private sector growth only generates positive returns for entrepreneurs. It is further exacerbated by limited access to growth capital targeted to SMEs and a low penetration of business development support options.

Firms with fixed capital of up to NPR 500 million (~ CHF 3.8 million) are categorised as SMEs in Nepal.[3] In absence of exact data, most are assumed to be much smaller than such a threshold with nearly 75% of all establishments having only up to 2 persons engaged.[4] SMEs have difficulty accessing credit through formal channels due to a number of reasons including the inability to demonstrate creditworthiness owing to lack of proper book-keeping, high collateral requirements, and often a lack of prior experience accessing formal finance. Banks, on the other hand, consider lending to SMEs as riskier and costlier compared to lending to larger businesses. While the Nepal Rastra Bank has mandated commercial banks to invest a certain portion of their loan portfolio in priority sector lending such as in agriculture, energy, tourism, and for micro, small and medium- enterprises (MSMEs), the incentive for the banks to invest in SMEs over and above the statutory threshold is limited.[5] In addition, SMEs often lack crucial skills in branding, marketing, business and financial management, accounting, and technical know-how to be able to pursue innovation, business expansion, explore new markets and increase their overall performance. In other markets, these gaps are filled by business development service (BDS) providers who bring the skills and expertise that SMEs may not have available in-house.

BDS refers to the provision of knowledge, skills, information as well as advice on the various aspects of a business. This includes business management and planning, financial management and accounting best practices, branding and marketing and integration of new technologies (e.g. online sales and digital payments), among others. Nepal Economic Forum has identified the quality of existing BDS as a cause of concern, as they are often found to be too generic and lacking relevance.[6] Consequently, the demand for BDS is low among entrepreneurs and BDS providers struggle to remain financially sustainable. With challenges that limit access to formal capital and in absence of a sound BDS system, the SME landscape across sectors is characterised by low productivity, traditional enterprising, and a latent innovation potential. If SMEs outside Kathmandu were to be more competitive, they could grow substantially and contribute to the achievement of Provincial development goals. This would break the vicious cycle of

---

[1] Nepal Rastra Bank. 2019. *SMEs Financing in Nepal*. (Kathmandu).
[2] World Bank. n.d. Doing Business 2020 Factsheet: South Asia. [Accessed 18 February 2021].
[3] Pioneer Law Associates. 2020. *Highlights on Industrial Enterprise Act, 2020 (2076)* [Accessed 18 February 2021].
[4] Central Bureau of Statistics. 2019. *National Economic Census 2018: National Report.* (Kathmandu).
[5] Nepal Rastra Bank. 2020. *Monetary Policy for Fiscal Year 2020-21*. [Accessed 18 February 2021].
[6] Nepal Economic Forum. 2019. *Mapping of Nepal's evolving Start-up Ecosystem.* (Kathmandu).

SMEs struggling to achieve scale and visibility and also contribute to bringing better quality services closer to the people, thereby strengthening federalism's goals in Nepal.

b. Approach

SDC envisages to develop a sustainable and replicable model based on a public-private development partnership logic to improve service offer to SMEs. It intends to do so by creating a new partnership between commercial banks and BDS providers to bridge the knowhow and financing gap faced by SMEs. It would be achieved by developing a loan product that is coupled with a BDS package. The mutual interest of SMEs and the financial institutions serving them in the success of the enterprises' will enable to bridge SME's trust deficit in using BDS. Financial incentive will be used to initially encourage SMEs to opt for BDS. Such support is envisioned to taper off as SMEs realise the positive impact of BDS and are motivated to demand and self-finance BDS in the future. Public resources, i.e. grants from SDC and potentially from partner Provincial Governments (PGs)[7] will also be used to incentivize partner commercial banks to extend such a loans to SMEs that fulfil at least the minimum criteria set by the programme[8] with the possibility of building in special incentives to target particular groups of SMEs such as women-led enterprises, climate smart/friendly enterprises, digitalisation pioneers, companies with disruptive business models. As such, the grant will be used to incentivise commercial banks to extend loans to SMEs with risk profiles that would otherwise not have been able to access finance through them. Currently the loan product is envisioned to be a commercial one. However, there could be scope for grant financers (particularly PGs) to also support SMEs by subsidising some of their cost of credit. Figure 1 below charts the approach as envisioned by this project.

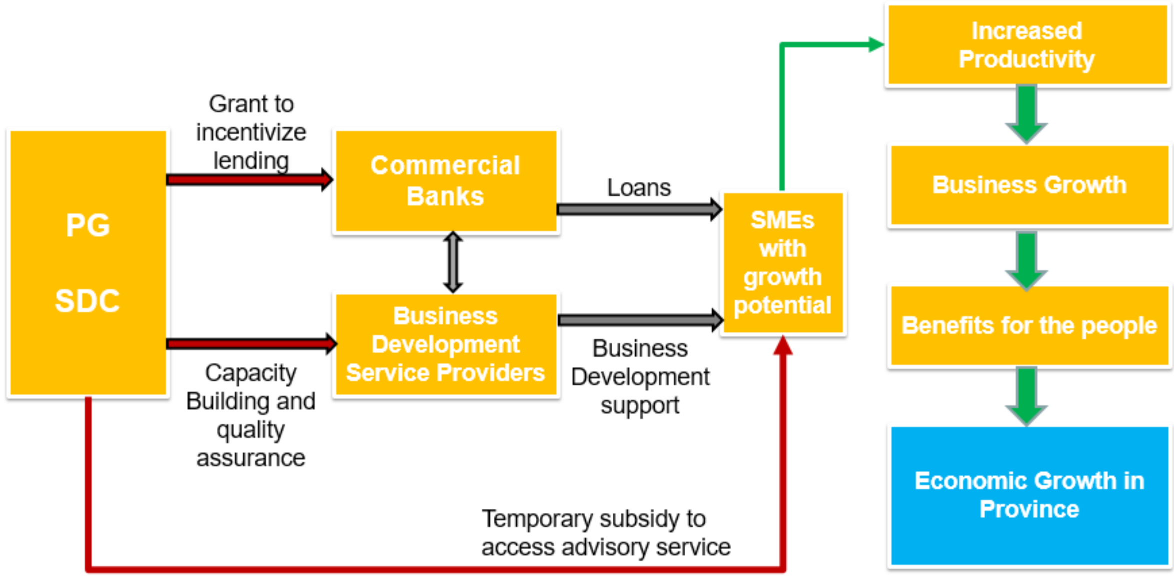

Figure 1: Project map

c. Switzerland's strategic priorities in Nepal

SDC is the Development Agency of Switzerland's Federal Department of Foreign Affairs (FDFA) and it is responsible for coordinating and implementing Switzerland's international development activities. Under its Cooperation Strategy for Nepal 2018-2022, Switzerland pursues a comprehensive approach, aiming to ensure that "women and men benefit from equitable socioeconomic development and exercise their rights and responsibilities in an inclusive federal state". The Cooperation Strategy has three strategic priorities, namely 1) building a federal system, 2) strengthening economic growth and job creation, and 3) enhancing protection of migrant workers and establishing an effective mechanism for migration management.

[7] Partnership with Provincial Government(s) is envisioned but not confirmed till date.
[8] The criteria are yet to be defined but the objective is to target enterprises that contribute to the achievement of socio-economic development goals of potential partner PGs.

These three pillars are complementary and mutually reinforcing. While the envisaged project has its roots in the employment and income domain of Swiss Cooperation in Nepal, it is inextricably linked with the other two strategic priorities as well. This project will work to strengthen SMEs outside Kathmandu—where economic activity is already highly concentrated—and potentially partner with PGs in improving service offer to SMEs and their ability to grow. Supporting the realization of spatially diffused economic growth and supporting the PGs to take a lead role in developing the entrepreneurship ecosystem, this project contributes to strengthening federalism in Nepal. Similarly the growth of SMEs as anticipated by this project can lead to the creation of new opportunities for returnee migrant workers to integrate into the labour market and entrepreneurship ecosystem.

d. SDC's existing work in entrepreneurial ecosystem development

With the *Mapping of Nepal's Evolving Startup Ecosystem* study commissioned by SDC in 2019 and subsequent stakeholder meetings, SDC has contributed in developing a sound understanding of the constraints faced by enterprises in Nepal. Since then, SDC has been engaged in policy dialogues with the Government of Nepal at the macro level through its support in the development of the national start-up policy draft and the support via the World Bank in the development and implementation of a private sector-focussed post-COVID recovery programme and institutional platform to foster business renewal and private investments. At the micro level, efforts from SDC and other development partners have been geared towards creating an enabling environment for new enterprises. SDC's support to the the COVID-19 MSME Fund Nepal which provides promising Nepali MSMEs with concessional financing and technical assistance (TA) to recover from the adverse business impact of the pandemic is an initiative which has some important parallels with the IIED project and therefore is an important source of learnings. Furthermore, SDC has played a lead role in creating a common platform for development finance institutions (DFIs) interested in Nepal—especially through its partnership with CDC Group and FMO on the *Nepal Invests* initiative—and development partners (DPs) aiming at patiently promoting young entrepreneurs and private, innovative activities in Nepal.

SDC in Nepal also has a long-standing experience in sectoral initiatives related to migration, agriculture and technical and vocational education and training (TVET). In these sectors, private sector development is a cornerstone and a force multiplier as enterprises create opportunities for better jobs and are catalysts in transforming traditional sectors like agriculture. Existing SDC programmes such as Nepal Agriculture Market Development Programme (NAMDP), Enhanced Skills for Sustainable and Rewarding Employment (ENSSURE), and a pipeline project on Re-integration of Returnee Migrants (ReMi) are all anticipated to have close synergies with IIED.

2. Objective of the assignment

Section b. of Chapter 1 broadly explains the approach that has been envisioned under IIED with a loosely defined structure on financing and partnerships. From **Figure 1**, it is also clear that there are two distinctive sets of partnerships, i.e. one that flows from the grant financers to banks and BDS providers and then to SMEs in the form of a loan product with BDS, and another one which flows from grant financers directly to the SMEs to initially incentivise them to opt for BDS service package. The main objective of the assignment will be make deep dives into potential structures for both these distinctive sets of partnerships considering that it aims to bring risk (debt) capital and business development services together and also align the incentives of both public (PGs, SDC) and private (commercial banks, BDS providers, beneficiary SMEs) together to support SMEs' growth. Based on the deep dives into potential structures, the consultant will recommend the most appropriate structure under each distinctive set of partnership to SDC considering the pros and cons of each identified structure.

The consultant will have to take into account the following key considerations while conducting the deep dives and making a recommendation to SDC on the most appropriate structure:

- What are the incentives of different partners—both public and private?
- How can grants be used in a way that to the extent possible "incentivises and not subsidises"?
- What current market failures would each identified financing and partnership structure address?
- What are the risk of market distortion under each identified structure?
- What are the risk of moral hazard under each identified structure and how can they be addressed?
- What do private partners' (commercial banks, BDS providers) bring to the project?
- How can private partners' contributions to the project be maximised?

- What is the anticipated "leverage"[9] under each structure?
- What is the cost-benefit for SDC under each structure?
- How does/can each identified partnership structure (with Banks/BDS providers) complement/align/correspond to the provisions on directed lending from the Nepal Rastra Bank (NRB) as per the Monetary Policy for Fiscal Year 2020-21 and other directives and regulations of the NRB on priority sector lending and concessional lending?

SDC has identified some potential structures for both sets of partnerships which can serve as a starting point for the consultant for this assignment. They are described in Annex 1.

The consultant will also have to create a database of relevant stakeholders (commercial banks, BDS providers, SMEs) which will be drawn upon for consultation meetings as described in Chapter 3. SDC will share with the consultant its database of contact points for each set of stakeholders.

3. Methodology

The assignment will be carried out in three stages which are as follows:

a. Desk review and first draft

A comprehensive review of available literature and resources including completed and on-going projects around the world of similar nature will be conducted by the consultant through a desk review. SDC will provide the consultant with the available documentation which may include but is not limited to factsheets, brochures, reports, and websites of projects of similar nature known to SDC. In cases where it is possible, SDC can also connect the consultant with third parties such as any donor partners with similar projects in Nepal and/or similar SDC projects in other geographies. Based on review of available literature and other resources, the consultant will make a first draft of potential partnership structures which will be presented to SDC and comments and feedback will be incorporated.

b. Consultation with stakeholders

Based on the first draft of potential partnership structures developed, the consultant will carry out a round of consultation meetings with relevant stakeholders to test the viability of each of the identified structures. The key stakeholders will include commercial banks (including provincial offices in Province 1 and Lumbini), BDS providers, and SMEs. While consultation with Banks and BDS providers will need to take place one at a time, for SMEs this can be completed as focussed group discussions. SDC can initiate the first contacts with relevant stakeholders wherever necessary. The consultant is expected to conduct consultations with at least 5 commercial banks (and an additional one with an executive office holder of the Nepal Bankers Association), 5 BDS providers, and 25 SMEs.

c. Final review

In the final stage, the consultant will review the first draft of potential partnership structures based on the feedback and inputs received during the consultation with stakeholders and make adjustments wherever necessary. A final draft report will be prepared that clearly delineates the different options of potential partnership structures for both the sets of partnerships, i.e. (grant financers→Banks/BDS providers→SMEs; and, grant financers→SMEs).

4. Deliverables

The consultant shall provide SDC with the following:

- Detailed work plan, including a list of the planned consultations and meetings to be discussed with and endorsed by SDC prior to stage b under Chapter 3.
- Database of relevant stakeholders created by the consultant which is drawn upon for consultation meetings as described in Chapter 3.
- Short write-ups on the consultations with stakeholders;
- Presentations upon the completion of each stage under Chapter 3 on the findings and progress;

[9] Leverage is a ratio that measures the ability of grant finance to catalyse private investments. In the context of this project, it may also be defined to equate with the opportunity costs of foregone access to finance for SMEs if grant finance to incentivise lending were unavailable.

- Draft report that provides comprehensive and well-structured information on the potential partnership structures—including the consultant's recommendation of the most suitable and viable structure under both sets—answering the key questions delineated in Chapter 2. Draft report to be submitted to SDC by 7 May 2021.
- Final report that is prepared upon receipt of SDC's comments and feedback on the draft report and incorporation of changes as required. Final report to be submitted to SDC by 14 May 2021.

5. Qualifications and competencies of the international consultant

This announcement is open to a consultant or a team of consultants (national and/or international). The consultant or the team of consultants overall shall have the following expertise and skills:

- Solid practical and academic background related to private sector development, including access to finance and blended finance initiatives, and business development support services;
- Solid understanding of Nepal's development context, its financial system, and entrepreneurship ecosystem, including the regulations on directed/priority sector/concessional lending policies;
- Solid expertise and experience in the field of private sector and business development, ideally with some experience with public private partnership;
- A strong sensitivity and responsiveness to bringing forward and dealing with, gender and social inclusion, digital divide, inequality of opportunity faced by SMEs to finance growth, and kleptocratic political economy of private sector development in markets.
- Excellent analytical skills (quantitative and qualitative) and strong ability to communicate and summarize analyses in writing;
- Very strong writing skills in English;
- Good interpersonal skills and time management.

6. Indicative duration and allocation

Activities	No. of days
Preparation of detailed work plan	2
Desk review	7
Preparation of first draft based on desk reviews and presentation to SDC	7
Consultations and interactions with stakeholders and presentation of findings to SDC	10
Preparation of draft report and presentation to SDC	10
Preparation of final report and presentation to SDC	4
TOTAL	40

7. Submission Guidelines and evaluation criteria

Interested applicant(s) with relevant expertise and experience is/are requested to submit the following:

a) Updated CV(s) of the consultant(s);
b) A detailed budget, including all costs related to the assignment; and
c) A brief concept note (max. 10 pages) outlining the approach and methodology, as well as the proposed work plan/timetable for the assignment, suggestions for stakeholder meetings, and past experience(s) relevant to this assignment.

The proposals received will be evaluated based on the following headings with the corresponding weights as shown in the table below:

Heading	**Weight**
Understanding of the assignment	10
Methodology	20
Scope of work	20
Relevant experience	20
Timeline	10
Budget	20
Total	**100**

Applications are to be sent by email to SDC at (kathmandu@eda.admin.ch) with "Partnership and Financing Structure Research" in the subject line. Only complete submissions will be taken into consideration and phone calls will not be entertained.

The deadline for submission is Wednesday, 15 March 2021 at 23h00 Nepal Standard Time (UTC +5:45).

The results from the selection process will be communicated within 10 working days from the submission deadline.

8. Disqualification from future tender bid

Any consultant(s)—whether individual(s) or organisation(s), submitting applications will automatically be disqualified from bidding for the tender for Phase 1 of the envisaged project *Investment and Innovation for Economic Development*. By submitting an application for this assignment, the consultant(s) agrees to this condition. The selected consultant(s) will need to confirm their agreement to this condition in writing before commencing the assignment.

ANNEX 1

As mentioned in Chapter 2, SDC has identified some potential structures for both sets of partnerships which can serve as a starting point and reference for the consultant. However, by no means is the consultant expected to limit investigation only to these options.

1. Grant financers→Banks/BDS providers→SMEs

The key principle guiding this partnership structure will be that grant financers work as catalysts to induce investments from commercial banks which would otherwise have not invested into SMEs that the project intends to target. As such, it will be a credit enhancement instrument that can encourage investments into SMEs targeted by the project by improving their risk-return profiles and thus incentivising banks to invest. Also, since the fundamental idea is that SMEs obtaining loan product in this way would also be able to tap into BDS provided either through a BDS provider that works closely with the partner banks or by the banks themselves (if they have the capacity to do so), there is also a need to devise a structure that enables very close interface and smooth coordination between the banks and BDS providers (or the lending and BDS relevant departments of a single bank).

Under this set of partnership, SDC has identified two potential structures:

a) Catalytic first loss guarantee (up to a pre-specified threshold)

Grant financers (SDC, and potentially also PGs) are purpose-driven. In the case of this project, as providers of catalytic first loss guarantee, grant financers will aim to direct the flow of commercial capital towards a market segment which would otherwise have a risk-return profile that would not have encouraged banks to invest into. Secondly, the project aims to promote certain socioeconomic outcomes with Provincial development goals being the points of reference and therefore, a key objective is also to channel commercial capital towards these outcomes with SMEs as vectors. Finally, the project also has the potential to create some demonstration effect. That is to say, if the investment performance is robust and despite the availability of the catalytic first loss guarantee up to a pre-specified threshold the utilisation is still well under the threshold, it can send a market signal to the investors to adjust their risk-return expectations and to invest into similar SME portfolios even when a lower level of credit enhancement is available. In such a case, the 'unused' catalytic first loss guarantee amount can be used to further expand the size of the SME debt portfolio.

In practice, what this would mean is the following: For example, let us say that partner banks have NPR 10 million worth of risk capital to invest. However, they are currently unwilling to use these funds to invest into SME portfolio that the project intends to target because they are not encouraged by the existing risk-return profile. In this situation, there is a need for growth capital from SMEs side and there are loanable funds available with the partner banks but the mismatch in risk-return profiles prevents a loan transactions from being completed. In such a case, the grant financers would come in and provide x percentage of NPR 10 million as catalytic first loss guarantee and the availability of this would act as a credit enhancement improving the risk-return profile for the SME portfolio targeted by the project for the banks. This would enable the banks to make loan investments into SMEs and in the case of non-performance of loans for such portfolio, the loss of capital that is exposed first (worth up to x percentage of NPR 10 million) will be covered by the guarantee. In effect, this shields banks from pre-defined initial losses of investing into such an SME portfolio as targeted by the project.

While this arrangement has the potential to address all the three objectives of the grant financers as described above, there are nevertheless some risks involved. The first being the potential for the introduction of moral hazard in the partner banks' appraisal of loan applications. In other words, the availability of the catalytic first loss guarantee could encourage potentially perverse risk-taking behaviour from the partner banks. It is therefore important to structure the partnership in a way that this concern is adequately addressed. Secondly, there is also a concern around distortion of markets, i.e. would the alteration of risk-return profile for the SME portfolio as targeted by the project work against the objective of building a commercial market? To an extent, this concern is addressed by the fact that this arrangement would seek to serve a previously unserved or underserved market segment. However, it is nevertheless important to delve into further details and analyse this issue more thoroughly.

b) **Origin-linked first loss facility**

As discussed above, grant financers are purpose driven and a key drive for this project is to also promote private sector activities that are innovative, add both social and economic value, and are responsible and sustainable. The origin-linked first loss facility shares many similarities with the catalytic first loss guarantee discussed above and it also works towards achieving the same objectives, faces the same risks/concerns of moral hazard and potential for market distortion. However, it goes a step further than the catalytic first loss guarantee by putting a more nuanced focus on the potential SME portfolio.

Unlike in the catalytic first loss guarantee, there will not be a blanket pre-specified first loss capital pledged by the grant financers against the available risk capital. However, the banks will be eligible to receive a certain percentage of the loaned fund (principal amount) as a "cashback" for each loan made to SMEs that fall within the criteria developed by the project and covering loan investments within a pre-determined range. The volume of loans for which such a facility will be available will depend on the sum total of resources available with the grant financers to that end. The "cashback" received by the banks for each disbursed loan can be pooled into a first loss facility which it can use to cover any losses arising from the portfolio.

For example, the banks may be eligible for such "cashbacks" for loans that fall in the typical "missing middle" range such as NPR 2 – 5 million with the proportion of such "cashback" tied to the market segment within the criteria developed by the project as shown in Table 1 below:

GC+ Priority 1, 2, 3	6%	2%	2%	2%
GC + Priority 1 & 2	6%	2%	2%	
GC + Priority 1	6%	2%		
General criteria (GC)	6%			

Table 1: Upward cascading "cashback" mechanism

Priorities 1, 2, 3 as shown above will be defined by the project and could include elements such as: climate smart business model, disadvantaged group-led enterprise, innovative or disruptive business model, etc. as potential priorities. Loans to enterprises that fulfil any combination of those priorities will accordingly yield “cashbacks” to the banks which they can use to cover losses arising from the entire portfolio. The maximum available resources from grant financers to provide such “cashback” need to be pre-determined for every level of the cascade.

Note that the percentage of “cashback” associated with the general criteria and priorities presented above are only examples used for explanation sake and do not serve to indicate SDC’s position on them. The consultant, based on desk review and stakeholder consultations, will need to provide SDC with a best estimate of what such “cashback” proportions can/need to be in order to generate sufficient interest from the banks to engage. The criteria, however, will be established by the grant financers.

For reference, an example of a current project that follows a similar modality is the Aceli Africa programme.

2. Grant financers→SMEs

Business development services are “experience goods”, and SDC has identified that one of the key reasons for SMEs’ unwillingness to pay for BDS or for the weak demand for BDS is precisely their lack of experience of having availed of such services in the past and the consequent perceived doubt about their effectiveness. This becomes even more pronounced when these services are only available commercially, as they are viewed as being an additional cost with uncertain benefits. While it cannot be denied that there are quality concerns in the BDS market, the IIED project through its technical assistance to BDS providers for capacity building and quality assurance seeks to address this issue.

However, even if quality-related concerns are alleviated to an extent, the SMEs will still need some form of encouragement to avail of these services and to “experience” them first-hand. In order to do this, IIED project seeks to mobilize grant financers resources in order to incentivise SMEs to avail of these services—by initially paying for their access to BDS which gradually transforms into co-financing with decreasing share of support from SDC and eventually into a completely self-financed service purchase by the SMEs. The tapering off of the support will be linked to the demonstrable positive effects of BDS on business performance of SMEs.

An example of a potential structure to incentivise SMEs to avail of BDS has been developed by SDC below and can serve as a reference for the consultant. However, this is only presented as one of the potentially multiple ways of structuring such incentives and as mentioned in Chapter 2, the consultant will make deep dives into potential structures and recommend the most appropriate and viable one to SDC.s

Example
For a nine-month long BDS project for a single SME, the cost of first three months would be covered completely by the grant financers. After the first three months an independent assessment will be made

on the impact of BDS on business performance[10]. A positive result will imply a change in the modality of payment into a co-financing model wherein the grant financers pay for 50 percent of the BDS cost for the next three months. At the end of this period another independent assessment will be made and a positive result will imply that the SMEs will cover 100 per cent the BDS cost over the remaining three months. A final independent assessment will be carried out at the end of the BDS project to evaluate the overall impact of the service on business performance of SMEs.

Months	**Grant Financers' share**	**SMEs' share**	**Total**
1-3	100	0	100
Independent assessment I			
4-6	50	50	100
Independent assessment II			
7-9	0	100	100
Independent assessment III			

In case independent assessment I and II indicate no net change or negative change, corrective measures will be taken by the BDS provider and the financing structure existing immediate before the independent assessment will be continued until the assessment period. At the end of independent assessment III, if there is no net change or negative change recorded, the grant financers will reimburse the SMEs' of the cost borne by them during the BDS project.

[10] The independent assessment would have to control for exogenous factors that affect business performance which are outside the scope of BDS intervention. Positive business performance would also cover the setting up of processes, structures, systems, and controls in place which are considered important to help optimize business performance noting that there is generally a time lag between structural improvements and the associated positive results.