

## The Landscape of SME Financing and Sustainability of SMEs in Bangladesh

### 1. Background of the Study

Small and Medium Enterprises (SMEs)<sup>1</sup> are the dominant form of business organization in all countries, generally representing more than 95% of the business population. OECD recognized that SMEs constitute an important dynamic element in all economies as they drive innovation and play a key role in driving sustainable economic growth, employment creation and poverty reduction, particularly in developing countries. It also contributes to the social, cultural and environmental capital of nations. SMEs are regarded by many governments and international developmental organizations as engines of innovation, economic growth, employment generation and poverty reduction. The role of Small and Medium Enterprises (SMEs) is indispensable for overall economic development of a developing country like Bangladesh. Since this sector is labor-intensive with short gestation period, it is capable of increasing national income as well as rapid employment generation of the marginalized people; achieving Millennium Development Goals (MDGs) especially eradication of extreme poverty and hunger, gender equality and women empowerment. SME sector has played a vital role in economic development of some developed countries of Asia especially Japan and Malaysia. Most of the Asian developing countries have also given due importance on SME. Terming SME as 'employment generating machine' they stressed on SME development for higher economic growth, narrowing the gap of income inequality and poverty alleviation. The present government of Bangladesh has also put much emphasis on the development of SME sector considering it as 'the driving force for industrialization'.

The Bangladesh Government declared Vision-2021 which is the golden jubilee of the achievement of independence of Bangladesh. Vision-2021 is the first document of its kind in Bangladesh which presents a roadmap for the country's economic development. It projects that contribution of the industrial sector to the Gross Domestic Product (GDP) would increase from 28 per cent (2008) to 40 per cent, contribution of the agriculture and service sectors would fall from 22 per cent and 50 per cent (in 2008) to 15 per cent and 45 per cent respectively by 2021. That means emphasis would be put on local industrialization and rehabilitating the surplus labour force of the agriculture sector in the industrial sector. To implement Vision-2021, the Planning Commission has drawn up the Perspective Plan of Bangladesh (2010-21). Perspective Plan target

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<sup>1</sup> According to the National Industrial Policy-2010 and Bangladesh Bank, medium enterprises in the manufacturing sector are enterprises with either the value (replacement cost) of fixed assets, excluding land and building, ranging between Tk 100 million and Tk 300 million or the number of workers ranging between 100 and 250. In the services sector, a 'medium enterprise' is an enterprise with either the value (replacement cost) of fixed assets, excluding land and building, ranging between Tk 10 million and Tk 150 million or the number of workers ranging between 50 and 100. In the manufacturing sector, a small enterprise is an enterprise with either the value (replacement cost) of fixed assets, excluding land and building, ranging between Tk 5 million and Tk 100 million or the number of workers ranging between 25 and 99. In the services sector, a 'small enterprise' is an enterprise with either the value (replacement cost) of fixed assets, excluding land and building, ranging between Tk 0.5 million and Tk 10 million or the number of workers ranging between 10 and 25. If a firm is in the 'small' category as per a certain criterion and in the 'medium' category based on another criterion, the firm will be deemed a 'medium' category one.

of achieving the annual GDP (gross domestic product) growth rate of 10 per cent by 2021 is premised on a competitive manufacturing sector growing at or nearly a double-digit rate during the 2010-21 decade. Consequently, the broad industrial sector will continue to account for a much larger share of GDP, approaching 37 per cent by 2021, compensating for the decline in the share of the agricultural sector, which will fall to 15 per cent. Vision 2021 stipulates the middle income status for Bangladesh by 2021 with the achievement of an annual GDP growth rate of 10 per cent by that year and averaging 9.2 per cent for the period of 2011-21. Fulfillment of this vision requires good performance of the manufacturing sector to take its share in the GDP to 27 per cent by 2021 and that of the industrial sector to 37 per cent.

The small and medium enterprises (SMEs) sector was given priority in the National Industrial Policy-2010. It was stated that achieving the recently-announced Digital Bangladesh goal by 2021 and creating employment opportunities for at least one person from each household in order to reduce poverty and unemployment were among the central policy objectives of the government. There is no alternative to creating an environment conducive to development of small and medium enterprises for attaining that goal. Attaching priority to this very fact, the National Industrial Policy-2010 has considered the SMEs as the thrust sector, given the planned and balanced development of these labor-intensive industries as the engine of growth.

## Objectives of the study

The present study focus on the current landscape of SMEs in Bangladesh as well as suggest some policy recommendations for the sustainability of SMEs in Bangladesh. The specific objectives of the study are to: i) examine the role of SMEs in the economy of Bangladesh ii) analyze the current framework and policy issues of SMEs in Bangladesh iii) review the present situation concerning their access to finance by SMEs and ; iv) identify the major financing constraints to the development of SMEs in Bangladesh; and v) finally put forward some specific recommendations for future growth and sustainability of SMEs in Bangladesh.

## Methodology

The study is mainly based on secondary data. Data have been collected from different published materials like the publications of Bangladesh Bank, Bangladesh Bureau of Statistics, Ministry of Finance, Various Commercial Banks, World Bank and relevant writings of some scholars. Unpublished data have also been collected from various departments of Bangladesh Bank. The collected data have been processed manually and this paper in the present form has been prepared in order to make the study more informative, analytical and useful for the users. Tabular and graphic representations are made with the help of MS Word and MS Excel.

## Organization of the report

The paper is organized into eight sections. The first section describes the background, objectives, methodology. The introductory section is followed by the role of SMEs in Bangladesh economy. Third section depicts SME development framework of Bangladesh. Section four portrays

constraints to SME development in Bangladesh. Section five presents status of SME financing in Bangladesh. Section six exhibits how SMEs can improve access to finance for its sustainable development. Section seven displays comparison of SME framework in APEC economies. Finally recommendations and conclusion are presented in section eight.

## 2. The Role of SMEs in Bangladesh Economy

There is now a well established recognition of the role that Small & Medium Enterprises (SMEs) play in developing economies. SMEs provide output gains and a broadening of employment opportunities that in combination helps improve wealth distribution. In addition, the SME sector provides a stepping-stone for more ambitious micro-enterprise owners, local supply chain engagement for more established companies and sometimes will act as an incubator for larger enterprises to flourish. Generally, SMEs will employ intermediate technologies and tend to generate significant employment opportunities with modest capital inputs. They will often also exhibit (i) greater business flexibility, (ii) a tendency to apply technological advances and, (iii) general production and distribution efficiencies. Although governments recognize the benefits of a healthy, growing SME sector, their policies are not always well-aligned to provide optimum support to the SMEs.

The recent available estimates obtained from two major micro surveys, International Consulting Group (ICG) study and South Asia Enterprise Development Facility (SEDF) survey suggest the SME contribution to manufacturing value added to be in the range of 20 to 25 percent (Ahmed 2008; Bahar and Uddin 2007). The micro, small and medium enterprises (MSMEs) together employ a total of 31 million people, equivalent to about 40 per cent of the population of Bangladesh, aged 15 years and above. More than three quarters of the household income in both urban and rural areas are provided by the MSMEs (Rahman 2007). SMEs can make a significant contribution to reducing poverty because of its importance to the Bangladesh economy. The estimated number of SMEs in Bangladesh varies from 6m (an estimate from the ADB<sup>2</sup>) to the 3.3m registered SMEs in the country. SMEs make up 80% of industry employment, and 90% of all enterprises in Bangladesh<sup>3</sup>. Their total contribution to export earnings varies between 75% and 80%, according to a recent economic census. In terms of GDP, SMEs contribute a quarter in Bangladesh.<sup>4</sup> The contribution of agriculture to GDP is similar to that made by SMEs, with some overlapping. However, in some countries the rate can be much higher. Currently the economy of Bangladesh is witnessing transformation from an agro-based economy to an industrial one. According to the World Development Indicators Study Report published by the World Bank, the contributions of industry and agriculture to GDP were respectively 21.7 per cent and 30.4 per cent in 1991, 25.9 per cent and 24.1 per cent in 2001, 28.5 per cent and 18.6 per cent in 2010. As per recent statistics of Bangladesh Economic Review-2014, the contributions of agriculture and industry to the GDP were 13.09 per cent and 29 per cent

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<sup>2</sup> Asian Development Bank, 2009, *Bangladesh Financial Sector: An Agenda for Further Reforms*, Manila

<sup>3</sup> Giesen and Lincing, 2006, *Enterprise Structure in Bangladesh*

<sup>4</sup> MIDAS, 2009, *Women Entrepreneurs in SMEs: Bangladesh*

respectively in the fiscal year 2012-13. Small and medium enterprises (SMEs) proved their potentiality in productivity, employment generation and poverty reduction as a reliable tool. As a result, policymakers throughout the world emphasize SMEs as the engine of growth and reduction of unemployment and poverty. SMEs are generating more jobs with comparatively nominal investments. Subroto Som, Global Head of SME Banking at Standard Chartered, was quoted (Daily Star, 14 November 2011) as saying: “The SME sector is the backbone of economies. Depending on the country, the sector can contribute anywhere from 30 to 70% of GDP”. This suggests that the potential for SMEs to drive the economic engine of Bangladesh is far from fully exploited.

### **3. SME Development Framework of Bangladesh**

For the purpose of SME development in Bangladesh, the following four-tier structure is set up.

Tier1-National Council for Industrial Development(NCID) [Headed by Hon'ble PM]; Tier2- Executive Committee of National Council for Industrial Development (ECNCID) [Headed by Hon'ble Minister for industries]; Tier3- National SME Taskforce[headed by principal secretary to the Hon'ble PM]; Tier4- Coordination Committee [Headed by Secretary Ministry of Industries]. Other Major Stakeholders of SME Development in Bangladesh are: Ministry of Industry- Bangladesh Small and Cottage Industries Corporation (BSCIC) ,Small and Cottage Industries Training Institute(SCITI), Bangladesh Industrial Technical Assistance Centre(BIT AC), Small and Medium Enterprise Foundation (SMEF) like OSMEP of Thailand; Ministry of Finance; Ministry of Information Technology; Ministry of Youth and sports; Ministry of women and children affairs; Bangladesh Centre for Scientific and Industrial Research(BCSIR) etc. The Private sector SME development stakeholders are: The federation of Bangladesh Chambers of Commerce and Industry (FBCCI); Dhaka Chambers of Commerce and Industry (DCCI); Metropolitan Chambers of Commerce and Industry (MCCI); National Association of Small and Cottage Industries in Bangladesh (NASCIB); Sector Level Associations; Private sector research and civil society organizations; Universities.

Bangladesh Bank(BB) has taken strong initiatives for SME sector development. BB's Policy regime has skewed in favor of the financially excluded and unbanked mass of the country specially towards the SME entrepreneurs with particular emphasis given to small entrepreneurs and women entrepreneurs. It has also given more emphasis on manufacturing and service sector that are more capable of generating employment equitable and enhanced economic development; and Traditionally developed industry clusters. Honourable Governor of Bangladesh Bank, Dr. Atiur Rahman took two milestone decision:(1)Creation of new department for looking after SME development activities and (2) Publication of a comprehensive guidelines for the banking sector to streamline SME lending and promotion activities in the banking sector. The goals of these decisions are: (1) Achieving enhanced economic growth; women empowerment; poverty alleviation and realizing the full potential of SME sector in development and (2) Creating a strong SME banking ecosystem. BB has also set up SMESP department with the objectives of Bringing SME banking under prudential

regulation; Ensuring proper use of SME loan through strong monitoring and control; Enhancing access to finance for the marginal, small and financially excluded women entrepreneurs there by broadening Financial Inclusion among the formal and non formal entrepreneurs; Supporting banks/Non Bank Financial Institutions in SME Banking capacity building; and Creating a small business banking friendly banking ecosystem. The functions of the department are: Regulation of SME banking activities of the banking sector; Policy related issues on SME banking; Monitoring of industrial loan ;Managing refinance schemes for SMEs; (BB, ADB, JICA); Women entrepreneurs development; Monitoring of SME lending in the banking sector; Refinance scheme for agro based industries; Affordable housing finance and Other relevant activities.

## Bangladesh Bank(BB) strategies for SME development

BB's SME sector Development strategies are two pronged: (1) Comprehensive policy guidelines to steer the banking sector towards the SME banking space 2) Providing a window [Refinance fund] of low cost fund for the banks and FIs to guide them to the targeted SME segment so that a credit market IS developed in that segment. As per these strategies, Bangladesh Bank has issued SME credit policy and programs where following a number of new measures have been taken: (1)Targeted Credit Initiative(TCI) (2) Cluster Based Lending(CBL) (3) Women Entrepreneurship Development(WED) (4) Promotion of SME issues (5) Training [for bankers and entrepreneurs] (6) Incentives for bankers.

Refinance Window/Scheme of BB: To overcome the financial constraints of the SME sector and induce banks and Financial Institutions to provide credit facilities to SMEs, BB is running the following dedicated refinancing funds for SMEs at a subsidized interest rate(bank rate) which is now 5%.

(1) Bangladesh Bank Fund- Objectives: to provide loans to Small Enterprises. Total fund is BDT 6.00 billion [revolving].

(2) Women Entrepreneurs Fund- Objectives: to provide Loans to Women Entrepreneurs. Total Fund is BDT 2.63 billion [revolving]

(3) ADB Fund-Objectives: to Provide loan to SME enterprise outside two major metropolitan areas. Total Fund is EDT 7.00 billion [revolving]

(4) JICA Fund-Objectives: to provide medium to long term credit for investment in productive facilities. Total Fund is BDT 4.5 billion

(5) Agro based Product Processing Industries Fund-Objectives: to provide Loan for agro based and agro product processing industries development. Total Fund is BDT 2.00 billion

## Cluster Based Lending (CBL)

Cluster is a geographic concentration of interconnected businesses, suppliers, and associated institutions in a particular field. Clusters are considered to increase the productivity with which companies can compete, nationally and globally. Benefits of Clusters are: *increasing productivity, driving innovation, and building new business*. Bangladesh Bank, SMESPD has so far identified more than 100 clusters around the country. BB has assigned individual banks to each of the clusters. Cluster based targets are also taken. Active support is being given to banks in financing on a cluster based approach.

## Women Entrepreneurship Development:

The initiatives which have been taken for Women entrepreneurship development (WED) are: (1) 15% of all refinance window to be specified for WE (2) A 10% target for WE lending of total SME (3) Interest rate cap for WE loan under BB refinance Window (bank rate + 5%); currently bank rate is 5% (4) WE loan application to be given priority (5) WE facilities provided by banks to be broadcasted in mass media (6) Group based lending allowed to WE (7) Up to Tk. 25 million clean exposure limit for WE [without any collateral] (8) WE dedicated help desk to be opened by the banks & FIs.

## Monitoring of SME credit by BB:

Bangladesh bank has started strong monitoring of SME Financing and SME promotion at three levels: BB Head office; BB branch offices and Banks & FIs Head offices. The Key Monitoring Areas (KMAs) are: (1) Target achievement (2) Sectoral Distribution (3) SE -ME ratio (4) Women Entrepreneurs financing (5) Geographical distribution (6) Cluster financing (7) NPL.

The Key Monitoring Indicators (KMIs) are:

(1) Target achievement percentage (2) Sectoral composition of disbursed loan [Percentage distribution] (3) Percentage of Small Enterprise loan to total SME loan disbursement [A minimum of 40% of total SME portfolio] (4) Percentage of Women Entrepreneurs credit compared to total SME disbursement [10% targeted] (5) Percentage of SME NPL to total SME outstanding and total loans and advances outstanding. The monitoring tools are: (1) Quarterly Reporting to BB HO (2) Simultaneous Reporting to BB branch offices (3) Mobile Monitoring (4) Monitoring cell at HO and branch offices (5) On-site inspection by SMESPD & BB branch offices (6) On-site examination by Department of Banking Inspection (SME).

## BB's Training & Capacity Building Program

BB Provides training on SME development to bank officials through BBTA, SME and Special Programmes Department. BB encourages banks and NBFIs to organize

management skill training and financial literacy training for the existing customers and prospective customers. It also arranges joint program with international organization (IFC, WB, ADB, UAID, EU, JICA etc.) for capacity building of the BB's staff members and for the commercial bankers as well. IFC provides training on SME lending techniques. JICA program has specific capacity development programs for the banks and NBFIs. Apart from this, BB is rigorously supporting SME development initiatives of other stakeholders through handholding with other organization in SME development such as (1) Arranging stakeholders meeting with Chambers of Commerce & Industries, Trade bodies, SME promotion agencies of the government and Other stakeholders (2) holding joint workshop/seminar (3) extending marketing support to bankers and entrepreneurs through financing fair for entrepreneurs and bankers as well as SME products fair for supporting and developing marketing channel for the SMEs (4) Joint program with other public & private sector stakeholders in SME development. BB has also set up (1) SME help desk at the BB head office (2) Mobile monitoring from BB Head office (3) Entrepreneurs complaints handling cell and (4) Mobile/phone helpline for the entrepreneurs for banking related services and business development services.

A SME development Project called INSPIRED with the financial assistance of EU has been undertaken by Bangladesh Government. INSPIRED is the acronym for Integrated Support to Poverty and Inequality Reduction through Enterprise Development. The programme is funded by the Government of the People's Republic of Bangladesh and the European Union. Its objective is to develop SMEs in Bangladesh. It is managed by the SME Cell of the Ministry of Industries. The SME Foundation, Bangladesh Bank, Bangladesh Bank Training Academy (BBTA) and Bangladesh Institute of Bank Management (BIBM) are other implementing agents of this project. The aims of the programme are to: (1) deliver a multi-sectoral and inter-ministerial national strategy and action plan for SME development which addresses all aspects of SME support including improving the business environment in line with accepted international best practice; (2) develop a strengthened national capacity to plan and implement SME development; (3) establish effective SME networking mechanisms aimed at sharing best practice; (4) provide a SME Competitiveness Grant Scheme of EURO 6.5m to Business Intermediary Organizations such as Chambers Of Commerce and Industry or cluster associations to work with groups of SMEs to improve their competitiveness in the following sectors: agro-processing, natural fibres, leather, plastics, light engineering, electronics, furniture and textiles; (5) support clusters by using value chain development initiatives that seek to increase SME competitiveness in agreed sectors and provide capacity building to business intermediary organizations (BIOs) in lobbying, advocacy, networking, public-private sector dialogue and the provision of business development services (BDS) to their members; and support Bangladesh bank training institutions for the benefit of the entire banking industry by providing training courses for bank staff on providing appropriate banking services to SMEs.

## Government Support to SME Financing Schemes

SME Cell and SME Foundation: Considering the importance of SME financing, a SME cell has been created in 2003 in the Ministry of Industries (MoI). The cell has announced that 80 percent of total resources available for SME would be allocated specially for small enterprises. The SME cell also decided that BASIC and BRAC bank will be working together as lead banks and will be responsible for distribution of credit and venture capital fund in the short run. The SME Foundation (SMEF) is an independent organization established in 2007 with a view to making it an Apex body for looking after the SME sector. The SMEF is capitalized by the Government of Bangladesh with a total endowment of Tk.2 billion. In order to facilitate low cost credit to SMEs, the SME Foundation started credit wholesaling program of Tk. 2.00 crore and it is being implemented by MIDAS Financing Ltd. and Shakti Foundation on a pilot basis. The Foundation developed guidelines for conducting its credit wholesaling program so that SMEs can receive credit at a single digit interest rate under Program through partner organizations. The SME Foundation expects that the SME credit wholesaling guidelines would enable it to reserve Small and Medium Enterprises Development in Bangladesh refinancing funds and give it to banks and financial institutions at rates lower than that of the Bangladesh Bank. The Women Entrepreneurship Development Wing of SMEF seeks to promote the creation of favorable environment for women entrepreneurs through capacity building and bring them in the mainstream of development process and facilitate effective support for these target groups as well as extend support to women's trade bodies/associations for their building institutional capacity and competitiveness. In a recent move, the government handed over a Tk. 210 crore ADB grant received in 2004 to the SME Foundation. Under this program, banks and non-bank financial institutions will get funds from SMEF at 3-4% interest, while the entrepreneurs will be entitled to loans at 8-9%, in lieu of the present 13-16%. Apart from this, various government organizations including specialized banks are engaged in providing credit to the SME sector. A specialized bank, the BASIC Bank Limited (Bangladesh Small Industries and Commerce Bank Limited) was established in 1988 with the foremost objective of financing the small and cottage industries (SCI). It functions through 17 selected NGOs due to the high cost of operations. BASIC is mandated to provide 50 percent of loanable fund to small and medium industries and to follow strategies of Industrial Policy 2010. The bank also offers lower interest rates on SME lending compared to most other banks.

## Fiscal and Financial Incentive Support for SMEs by Government

Besides institutional and policy support for finance, the government also offers a number of fiscal and financial support to the industrial sector including SMEs. The government has lowered duty on import machinery. Businesses exporting 80% or more of goods or services qualify for duty free import of machinery and spares. Value Added Tax (VAT) is not payable on import of capital machinery and spares. Facility of 90% loans against letters of credit is allowed. The government also decided that small and medium manufacturing units would get a complete VAT exemption on utilities including electricity and phone, and insurance services.



## **4. Constraints to SME Development in Bangladesh**

SMEs are heterogeneous by their characteristics, mode of operation and types of SME products and processes. As such it is difficult to make sweeping generalization about constraints facing SME entrepreneurs. However, some of the constraints are discussed below:

### **Lack of Investment Finance and Working Capital Finance**

It goes without saying that access to finance particularly working capital finance and investment finance to enable them to expand their business is a prime constraint facing the SMEs. Banks in general do not consider SME financing as profitable activity. SMEs are also regarded as high risk borrowers because of their low capitalization, insufficient assets and high mortality rates, and consequently banks are not keen to offer them credit at comparable interest rates. SMEs in the export sector also face problems of access to working capital.

### **Enabling environment for Trade and Business**

Although trade and business activities are carried out by the private sector, existence of enabling environment like supportive regulatory framework, congenial tax regime, developed transport and communications infrastructure is vital for SME development. Bangladesh has made some progress in this direction but it still falls short of present day needs. Other constraints of a general nature are inefficient infrastructure support especially power, widespread tariff anomalies, low productivity of labor, low level of technology, lack of research and development and low level of education of SME entrepreneurs in general.

### **Non-Tariff Barriers (NTB) and Changes in World Trade Regimes**

Liberalization of industrial and trade regimes in the wake of globalization are likely to have significant effects on Bangladesh's SMEs. Over the past decade, there has been a significant change in the world trade regime with new regulations coming into effect. Lack of knowledge about the current status of WTO Agreements hampers trade and business.

### **Barriers in access to finance for women entrepreneurs**

Discrimination still exists regarding access to finance by women entrepreneurs. Studies show that women contribute around 26 per cent in total deposit of the banking system but their access to credit is below 2 per cent of the total outstanding loans. This is an unfortunate situation. Access to finance is one of the most critical constraints faced by women entrepreneurs. Most of the banks have SME banking, a few women apply for the bank loans as they need to submit a number of statements such as bank statement of the enterprise, reference of guarantor etc. for collateral free loans. Problems were more pronounced for women entrepreneurs in the informal sector. A recent study noted that about 79 percent of women entrepreneurs in this sector had no access to formal financial institutions and depended on own savings and family as source of capital to start a business (Chowdhury, Farzana, 2008). Banking system in Bangladesh is not adequately focused on women-owned enterprises. Banks usually consider women entrepreneurs

in SME to be high-risk borrowers. The kind of collateral usually considered by banks as appropriate security is land and building. Women usually lack ownership of land and hence the collateral requirement of land and building is a constraint for them to access institutional finance. Lack of collateral makes women entrepreneurs more risky for banks. Although women have proved their repayment capacity with a repayment performance of 90 percent in the field of micro credit, commercial banks perceive them to be of high risk. Most of the small women entrepreneurs do not have a credit history, and so there is no CIB report on them. These barriers induce female entrepreneurs to take recourse to informal sources of finance.

### **Inability to Market SME Product**

The present and future growth prospect of any product depends to a large extent upon marketing activity. This requires having a well-planned marketing strategy including advertisement campaign as well as resources for implementing that strategy. Unfortunately, SME entrepreneurs are at the bitter end in this respect as they cannot make adequate investments in marketing and also lack necessary marketing skills.

### **Inability to Maintain Product Quality**

A major constraint to the sustainability of SME growth in Bangladesh is the inability to maintain the quality of SME products. At present, Bangladesh produces mostly common consumer goods which are labor-intensive and require relatively simple technology. But due to poor quality these products cannot stand competition from imported products. The challenge for Bangladesh today is not in competing with high-tech products of developed countries but to make its SME sector survive by facing the competition from its rivals.

### **Lack of Skilled Technical Persons and Workers**

Lack of skilled manpower is a deep-rooted problem in Bangladesh. This problem is particularly acute for small and medium scale export oriented enterprises. Bangladesh has made large inroads in the world's apparel market through commendable performance of RMG sector. However, the value addition of the products is low. Despite high demand, Bangladesh cannot make much entry into high value fashion wear exports due to dearth of trained workers. Supply capacity is thus constrained by non-availability of skilled workers.

### **Poor Management Skills of Entrepreneurs**

In the modern day economy, managerial skills for undertaking planning, marketing, and cashflow management are vital for survival of an industry, small or large. SME entrepreneurs in Bangladesh are very much lacking in managerial skills and are not used to strategic planning. It is natural that they are unable to survive during market failures. The concept of managerial training for SME entrepreneurs is yet to take root in Bangladesh.

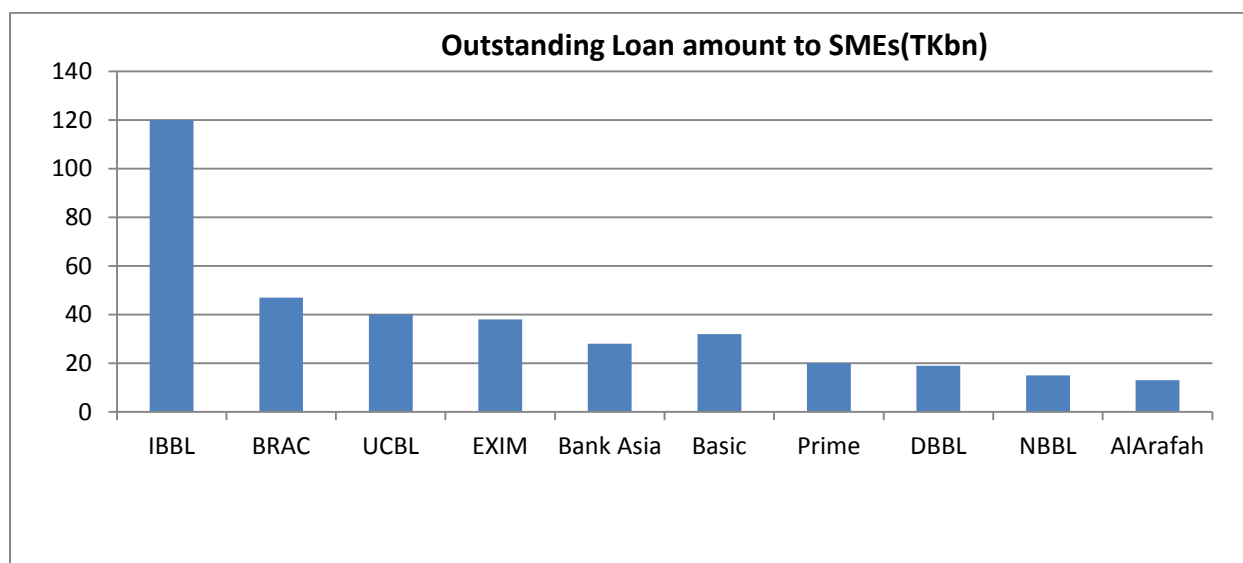
## **5. Status of SME Financing in Bangladesh**

The honorable Governor of BB, Dr Atiur Rahman, has emphasised the importance of investment in SMEs to make the country self-reliant and self-sufficient. He has noted that the contribution of the SME sector to employment generation is next only to agriculture. According to him, “Commercial banks have been playing a tremendous role in this regard through the timely guidelines from the BB (Daily Star, 24 April 2012).” Banks, Non-bank Financial Institutions, Co-operatives and various associations are the main formal providers of finance to the SMEs in Bangladesh.

There are 56 scheduled banks in Bangladesh. They operate under the regulation and supervision of Bangladesh Bank which is empowered to do so through Bangladesh Bank Order, 1972 and The Bank Company Act, 1991. Scheduled banks are classified into the following four types: State Owned Commercial Banks (SOCBs), Specialized Banks (SBs), Private Commercial Banks (PCBs), Foreign Commercial Banks (FCBs). On the other hand, Non Bank Financial Institutions (NBFIs) are regulated under the Financial Institution Act, 1993 and controlled by Bangladesh Bank. There are 31 NBFIs operating in Bangladesh of which two are fully government owned, one is the subsidiary of a SOCB, 13 were initiated by private investors and 15 are joint ventures.

Although financing of SMEs are largely dependent on equity financing from personal and family savings, from friends & relatives, at present banks and financial institutions are also coming forward to provide finance to this sector. Different initiatives have already been taken and practiced by the financial institutions in order to facilitate the SME financing. Some of those initiatives are as follows: separate SME division, SME units/centers and dedicated desk; separate SME dedicated desk for women entrepreneurs; Separate monitoring team for SME; separate team for selling loan and collecting deposit through SME products; special credit risk management team for SME banking; different trainings for SME officials as well as for entrepreneurs; commission/incentives based on the performances of direct sales team; dedicated collection team for SME loan; customized products and services for SME; establishment of SME/Krishi branch; delegate loan authority to the branch managers and head of SME up to a certain limit for quicker decision; 24 hours call center and doorstep banking; organizing SME service fortnight in every years; develop clusters under area approach etc. Figure-1 shows that Islamic Bank Bangladesh Limited (IBBL) has disbursed the highest amount of SME loans among the top SME financier banks. IBBL being the shariah based bank has given more importance on small and medium enterprise development banking.

**Figure 1: Largest bank lenders to SMEs, 2013**



Source: Author's Own Survey

Table 1 highlights the current status of the SME outstanding loan as percentage of total loan provided by the banks and non-bank financial institutions operating in Bangladesh. In 2012, SOCBs outstanding loan was the highest (27.10%) compared to SBs (21.03%), FBs (11.51%), and PCBs (22.78%) in the banking sector. The average of all banks showed that the total outstanding loan in the SME sector was 21.32%. It is observed that the FBs' outstanding loan in this sector was the lowest, only 11.51%. In case of the NBFIs, the total outstanding SME loan compared to its total loans and advances was 13.72%. The average of all banks and NBFIs was only 21.01%. There is ample scope for investment in this sector by the banks and NBFIs.

**Table- 1: Current Status of SME Loan outstanding as percentage of Total Loan (Tk. In Crore)**

Name of Banks/NBFIs	2012		2013	
	Bal. Outstanding of SME Loan	% of SME outstanding to Total Loans	Bal. Outstanding of SME Loan	% of SME outstanding to Total Loans
SOCBs	24534.26	27.10	22943.56	28.15
SBs	5104.05	21.03	7568.30	23.74
FBs	2395.66	11.51	2085.89	12.85
PCBs	55420.91	22.78	69529.16	20.72
Total Banks	90254.88	21.32	102126.91	21.88
NBFIs	2992.74	13.72	2979.38	12.97
Total Banks & NBFIs	93247.62	21.01	105106.29	21.11

Source: SME & SPD, Bangladesh Bank.

In 2013, the table shows that SOCBs outstanding loan in SME sector was 28.15%, which has increased compared to that of the previous year. The percentage of SME outstanding to total loans for each group of financial institutions is shown to be very similar for both the years. But the average of all banks and NBFIs represents 21.11% which is slightly higher than that of the previous year (21.01%).

Table- 2 shows the disbursement of small and medium enterprises loan on the basis of the total SME loans disbursed by the banks and NBFIs in Bangladesh. In 2012, the aggregate disbursement in small enterprises by all banks and NBFIs was 55.27%, while the aggregate disbursement in medium enterprises by all banks and NBFIs was 44.73%. Therefore, the banks' and NBFIs' total SME loan disbursement was concentrated more in small enterprise sector and less in medium enterprises sector.

Table- 2: Disbursement of SME Loan by Banks and NBFIs (Tk. In Crore)

	2012		2013	
Banks/ NBFIs	Small	Medium	Small	Medium
SOCB	1119.36 (58.49)	794.82 (41.51)	2374.81 (57.10)	1784.07 (42.90)
SB	766.25 (43.06)	1023.42 (56.94)	1190.48 (46.44)	1373.07 (53.56)
FCB	312.20 (44.08)	394.03 (55.92)	585.55 (47.17)	655.80 (52.83)
PCB	15128.53 (55.93)	11922.14 (44.07)	20714.05 (46.96)	23395.67 (53.04)
Total Banks	17326.84 (55.09)	14126.41 (44.91)	24864.89 (47.75)	27208.61 (52.25)
NBFIs	502.05 (62.57)	300.31 (37.47)	991.22 (60.22)	654.72 (39.78)
Total Banks & NBFIs	17828.89 (55.27)	14426.72 (44.73)	25856.11 (48.13)	27863.33 (51.87)

Source: Author's calculation, Data: SME & SPD, Bangladesh Bank.

In 2013, the concentration of total SME disbursement in small enterprises decreased to some extent from 55.27% to 44.73%, whereas, the disbursement to medium enterprise sector went up and stood at 51.87%.

Table- 3 highlights on the sector-wise disbursement of SME loan by the banks and NBFIs in Bangladesh. The disbursement of SME loan was categorized as service sector, trading sector and manufacturing sector.

Table- 3: Sector-wise Disbursement of SME Loan(Tk. In Crore)

Year	2011			2012		
Banks/ NBFIs	% to Service Sector	% to Trading Sector	% to Mfg. Sector	% to Service Sector	% to Trading Sector	% to Mfg. Sector
SOCB	3.94	60.67	35.39	2.82	58.06	39.12
SB	2.41	52.21	45.37	5.84	53.52	40.64
FB	15.00	48.59	36.41	9.74	50.57	39.69
PCB	6.56	68.82	24.61	4.97	67.01	28.02
Total Banks	6.35	66.87	26.78	4.99	65.33	29.68
NBFIs	25.67	43.70	30.63	23.85	46.03	30.12
Total Banks & NBFIs	6.94	66.16	26.90	5.47	64.85	29.68

Source: SME & SPD, Bangladesh Bank.

In 2011, the aggregate average of SME loan disbursement by the banks and NBFIs was 66.16% in trading sector, 26.90% in manufacturing sector and 6.94% in service sector. On the other hand, the 2012 figures revealed that 64.85%, 29.68% and 5.47% were disbursed in trading, manufacturing and services sectors respectively by the banks and NBFIs. .

Table 4: Disbursement of SME Loan to the Women Entrepreneur (Tk. In Crore)

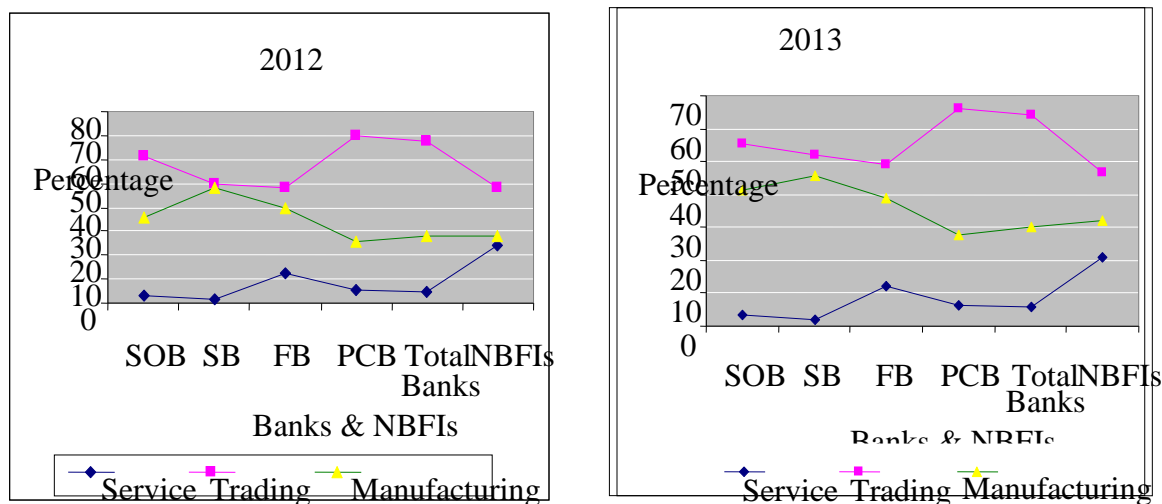
Banks/NBFIs	2011			2012		
	Total Disbursement	Disbursement to Women	% to Disbursement	Total Disbursement	Disbursement to Women	% to Disbursement
SOB	7723.99	73.89	3.51	2107.98	31.73	3.38
SB	2594.65	58.03	4.73	1225.89	43.98	6.72
FB	1033.92	2.88	0.49	592.12	1.28	0.46
PCB	40494.58	806.81	3.79	21302.00	348.32	3.51
Total Banks	51847.14	941.61	3.73	25227.99	425.31	3.61
NBFIs	1696.79	40.12	4.29	935.35	21.89	5.27
Total Banks & NBFIs	53543.93	981.73	3.75	26163.34	447.20	3.66

Source: SME & SPD, Bangladesh Bank.

Table 4 shows the status of SME loan disbursement to the women entrepreneurs by the banks and NBFIs in Bangladesh. In 2011, the average disbursement of SME loan for women entrepreneurs to total SME loan disbursement was 3.73% by all banks and 4.29% by NBFIs. The aggregate disbursement by all banks and NBFIs was only 3.75% in 2011. In 2012, the aggregate disbursement to women entrepreneurs by all banks and NBFIs was 3.66%. It would be a worthy contribution to the society and to women entrepreneurs if the banks and NBFIs can disburse more SME loan to them. It has been realized by and large that lack of access to finance is a key impediment to SME development in Bangladesh. This is more so in the case of women entrepreneurship development. In this context it is appropriate to make a review of the available

institutional support for SMEs and the problems faced by women entrepreneurs. Studies on SMEs have revealed that while SME loans are largely meant for meeting the needs of working capital, such loans meet around a third of the demand. The rest is met from own source, and partly by bank loans under other heads, friends/relatives and NGO sources.

Figure 2: Sector wise SME Access to Finance in Banks and NBFIs



Source: SME & SPD, Bangladesh Bank.

## 6. How SMEs can improve access to finance for its sustainable development

Three main problems which are given in box-1 are associated with the SME entrepreneurs for not getting the requisite finance for their businesses. There are a number of steps that SMEs can take to overcome these problems and improve their prospects for obtaining funding for their business, based on the analysis of what banks often require. The keys to success revolve around three main initiatives: seeking the best financing product; putting “the best foot forward” in the application process; and changing the business operation for the better.

### Seeking the most appropriate financial product

The first step is to consider what type of product is needed. This requires the SME to have a full understanding of its future financing needs which, in turn, will require it to develop some sort of a business plan, with details on its operation, products, employees, marketing and processes. It is then a matter of determining what type of product and what quantum of funding best meets the SME’s financing needs. Relevant questions include: Can it provide collateral, or must it seek a cash flow based not asset backed loan? Will the loans involve a priority sector for SME investment, e.g. agro-processing? When will the funds be needed and, if not the full amount on Day 1, can a facility with tranches be arranged? Is it possible that equity funding would be more appropriate than debt? Would other products be important, such as insurance coverage, particularly for agriculture?

Having agreed with the appropriate product or products, the SME should then look for the lender and/or provider most aligned with its interests. Considering the product terms, understanding and comparing interest rates is important and fees that banks charge on top of the stated interest rate

must also be considered. Finally, other terms can be just as crucial as the interest rate. There may be steps that the borrower must take which are time-consuming or expensive, e.g. registration of title or formal business licenses. If the required reporting regime is too burdensome, this adds to the effective cost of the loan. In addition, the borrower should ensure that the repayment terms of the loan align with its expected cash flows.

## Maximizing the SME's ability to qualify

Some of the key elements that a borrower must consider well in advance include: (1) Title to property to allow for collateralization (2) If collateral cannot be provided, the capacity to provide alternatives, such as security over assets liens, guarantees, and post-dated cheques (3) The ability to meet lenders' minimum client criteria, especially years of business operation (4) Physical access to financial services through visiting the bank branch or lending officer (5) An ability to prepare the loan application, given the complexity of some of the banks' forms. Preparing for the detailed reporting required as part of the lender's loan monitoring.

### **Box-1: SME Funding Issues**

**A. Project Preparation:** The first problem entrepreneurs face in seeking institutional finance is with regard to preparation of the project proposal. In spite of directives from the central bank to follow standardized procedure, the loan application process has still remained lengthy and cumbersome. The entrepreneur often lacks the ability to formulate a proper project proposal. Even when he prepares the proposal drawing on outside expert services, there is no guarantee that the proposal will be evaluated properly as the financial institutions themselves lack adequate capability for proper project evaluation.

Prerequisites, e.g. track record are a real problem for start-ups, business including loan proposal high processing and monitoring costs. The loan application forms are themselves often long, tedious and requiring redundant information.

Agriculture is seen as most at risk by lenders involving factors such as weather, diseases and changes in official policies.

**B. Collateral Requirements:** One of the main factors that have hampered flow of institutional finance into SMEs is banks' pre-occupation with collateral based lending. Traditionally banks have used fixed asset ownership, particularly land ownership as the basis for judging credit-worthiness. This puts SMEs at a relative disadvantage, as large entrepreneurs are often able to get around the problem because of their influence and contacts by putting up collateral of dubious valuation. The solution to this problem lies in banks seeking deposit relationship with owners of SMEs and using cash flow rather than asset ownership as the criterion for credit-worthiness. An expanded credit guarantee scheme will have to play a vital role in this regard.

**C. Bureaucracy and Corruption:** Because of lack of proper autonomy and accountability, the public sector financial institutions are beset with inflexibility, inefficiency, political interventions and corruption. Since the performance of the bank officials is not properly evaluated they lack the incentive to bring a large number of suitable borrowers, particularly those in the SME sector, within the fold of institutional financing. They adopt a passive and inflexible attitude towards the borrowers either to avoid the risk of making an inappropriate lending or to force the borrower to make side payments for more favourable handling of the loan application. Until necessary reforms in the public financial institutions are carried out, the SMEs will continue to bear the brunt of this institutional malice.

*Source: Rahman (2010)*



It is generally recognized that guaranteed schemes in various forms are required by the SMEs along with customized financial products. The SMEs are in especial need for longer-term resources. The Bangladesh Bank propagated some options for enhancing financial facilities to the SME sector of the country [Box-2]. In addition, banks and financial institutions can be encouraged to offer more and more innovative financial products such as factoring, venture capital, etc. However, the SME entrepreneurs as well as the financial instruments providers should be well acquainted with such products. Academicians and experts, time and again, opined for a dedicated new financial institution for SME in order to provide sufficient, long-term, low-interest funds with liberal terms of collateral.

Box-2: Enhancing SME Funding
<p>Lack of efficient inter-bank market to channel excess liquidity, lack of legal framework for development of alternatives for long-term financing such as securitized debt securities, lack of term funds at reasonable interest rates, high interest rates offered for government bonds often crowd out long-term borrowing for SMEs by Financial institutions. The following factors deserve consideration</p> <ul style="list-style-type: none"> <li>● Like the developed countries government can use grants as a major instrument to support the SMEs financially, which can be used as a subsidy.</li> <li>● Government can provide credit guarantee schemes to SMEs that is a common feature both in developed and developing countries. Such guarantee ensures repayment of any default loan taken by an SME.</li> <li>● Government can directly guarantees loans up to a certain limit to small businesses to purchase land, buildings or equipment. Loans may be made through banks or other financial institutions.</li> <li>● By implementing analytical software like credit scoring model based on available data from reliable sources, banks and financial institutions can provide loans to SMEs with growth potential and good track record.</li> <li>● In case of providing refinance to the banks and NBFIs, government should have some directives related to collateral requirement and high interest rate.</li> </ul> <p>Source: Financial Sector Review, Bangladesh Bank</p>

## 7. Comparison of SME Framework in APEC Economies:

**Indian Framework:** A large number of SME promotion agencies, including a full-fledged ministry, are working to develop and promote SMEs in India. Notable Indian SME development and promotion agencies are the Ministry of Micro, Small and Medium Enterprises, MSME Development Institute, SME Development Chamber of India, SME Export Promotion Council, Entrepreneurship Development Institute of India, SME Rating Agency of India Limited, India-Korea SME Council, Small Industries Development Bank of India, and the Federation of Indian Micro and Small and Medium Enterprises etc. Relevant agencies are conducting diversified types of research on different SME issues in India as well as abroad. Indian SME organisations have branches abroad to promote and support Indian SME entrepreneurs there. Cluster development is a popular mode of SME development in India. Besides these SME organisations, a large number of public and private sector organisations are working with cluster development in India. Indian SME organisations are publishing both free-of-cost and for-sale publications including business plan, identified potential business sectors, business opportunities

at home and abroad, business directories, directory of industrial laboratories, handbook to minimise risk in export market, and mandatory and non-mandatory standards on different industrial products in different countries. They also promote a few common activities like organising seminars, workshops, trade fairs, and linking businessmen with concern networks.

**Malaysian Framework:** The government agency to develop and promote SMEs in Malaysia is the SME Corp. The SME Corp is one of the leading organisations in Asia for SME development in terms of activities and areas focused. Technology development is one of their major activities; they assist SMEs to adopt new technology, increase productivity, automation, select appropriate technology and machinery, update production process and production management etc. Soft SME loan, Shariah-based SME loan and emergency fund for SMEs are their unique services in the region. Other mentionable activities of the SME Corp are capacity building, advisory and technical services, SME rating, SME university linkage, SME mentoring, national brand seal on SME products, SME expert panel database, company registration, company enlistment, publications and online SME services etc.

**Japanese Framework:** The Organisation for Small and Medium Enterprises and Regional Innovation, Japan serves the SMEs from four major aspects namely, support start-ups in new business development, support for SME growth and development, providing safety nets and infrastructure.

**Vietnamese Framework:** The Agency for Enterprise Development under the Ministry of Planning and Investment is responsible for SME development and promotion in Vietnam. It is implementing SME development policies and providing a series of services to the Vietnamese SME entrepreneurs including linkage with technology suppliers, regulatory consultations, establishing industry export and hi-tech zone, publishing business directory, directory of SME associations, directory of SME experts, directory of SME loan products being offered by SME banks etc.

**Chinese Framework:** The Bureau of China International SME Fair is the SME promotion government agency in China. They organize yearly SME fair, technology fair, world conference, boutique fair, seminars, workshops, work with environment-friendly SME development, providing youth entrepreneurs loan, providing start-up loan etc.

**Bangladesh Framework:** As mentioned earlier, a number of organizations are involved in SME development in Bangladesh. These are National Taskforce on SME Development, SME Cell, Ministry of Industries, SME Foundation, Bangladesh Small and Cottage Industries Corporation (BSCIC), Bangladesh Industrial Technical Assistance Centre (BITAC), Bangladesh Council of Scientific and Industrial Research (BCSIR), Business Promotion Council (BPC). The Federation of Bangladesh Chambers of Commerce and Industry (FBCCI) and numerous chambers of commerce and SME-based sectoral trade associations are involved in promoting SMEs. Bangladesh has declared 11 SME sectors as booster sectors. These are electronics and electricals, software development, light engineering and metal-working, agro-processing/agri-business/plantation agriculture/ specialist farming/tissue-culture, leather-making and leather goods, knitwear and ready-made garments, plastics and other synthetics, healthcare and diagnostics, educational services, pharmaceuticals/cosmetics/toiletries and designing and

aesthetically-challenging, personal wear and effects. The Bangladesh Bank provides refinancing facilities to commercial banks and other financial institutions against disbursed loans. Special institutional arrangement has been made to nurture SMEs by establishing SME Foundation, SME and Special Programme Department in the Bangladesh Bank and SME Cell in the Ministry of Industries. For ensuring SME-friendly infrastructural support in a particular area, the government is establishing industrial estates through the Small and Cottage Industries Corporation (BSCIC) and the Export Promotion Zones (EPZs) through the BEPZA (Bangladesh Export Processing Zone Authority). BISIC and EPZs have developed 79 industrial estates and eight EPZs respectively. To facilitate access to information among the SME entrepreneurs, 74 SME Helpline Centres have been established throughout the country. The government has taken initiatives to create skilled manpower in different trades through various training and development institutions.

## **8. Recommendations and Conclusion**

From the above analysis, we can see that a well-designed plan of action is required for creating an enabling environment in which both existing and aspiring SME entrepreneurs easily find what they really need such as information, counseling, mentoring, access to finance, marketing and technical assistance. Financing SMEs is one of the key prerequisites for the achievement of growth of this sector. Evidences from around the globe demonstrate that access to finance is a key problem that most of the private sector and the small enterprises face in both developed and developing countries. In Bangladesh also, the small entrepreneurs - both entrants and existing - significantly face obstacles in relation to the cost and lack of access to investment capital in spite of the efforts which have been made to alleviate them. To maximize the benefits of financial structures, the provision of finance should be accompanied by parallel efforts to improve the investment climate and to develop other SME support services. Various studies revealed that financial opportunities or higher effective rates of assistance provided earlier to the SMEs have contributed to the inefficiency in the sector. In order to develop SMEs the following measures may be undertaken in Bangladesh:

**SME Custer Development:** SME Foundation has identified 177 SME clusters all over Bangladesh. It is easy to transform these SME clusters into SME export processing zones, if the government and development organisations pay proper attention to it. A balanced development is possible, if the SME clusters are developed, because the clusters are located in different districts, upzilas, unions and even in villages throughout the country. It requires minimum resources to ensure all industrial facilities and utility services available in a specific area to develop an industrial cluster and get maximum output from it.

**Diversification of Exports:** The export basket of Bangladesh contains only a few products. Therefore, it is necessary to identify products having export potential and diversify the products in the export basket. Development of export-oriented SMEs could lead to robust employment generation, increase in export earnings and poverty alleviation.

**Introducing an Industry-friendly Tax Regime and Justification of the Existing Tariff Structure:** Export and import are linked with industrialisation. Export without import of raw materials is quite difficult. Therefore, an industry-friendly tax regime should be introduced to promote local

investments and attract foreign direct investment (FDI). The existing tariff structure should also be justified to promote local industrialization.

**Exploring Prospective Export Markets and Signing Free Trade Agreements:** The government should take necessary measures to explore the prospective export markets for Bangladeshi products and sign free trade agreements with them to ensure Bangladeshi products' duty-free and quota-free market access there.

**Technological Upgradation and Increasing Productivity:** Most of the industries in Bangladesh are lagging behind in terms of technology and productivity. As a result, we are unable to produce high-quality products for sale at competitive prices. Therefore, it is the government's duty to take necessary fiscal and monetary measures to facilitate technological upgradation to increase productivity of the local firms.

**Establishing Testing Laboratory and Assisting in Achieving International Quality Certification:** Most of the industrial sectors are suffering from the lack of proper testing facilities for their products to ensure their world class quality. Therefore, Bangladeshi companies are not getting international quality certificates. As a result, foreign buyers are not accepting our products on a large scale in the absence of quality assurance. So, it is the government who could help local entrepreneurs establish sector-specific testing laboratories and get international quality certificates and thus increase the acceptance of Bangladeshi products to foreign buyers. It will help to build the brand image and charge premium prices for quality products.

**Ensuring Adequate Supply of Raw Materials and Introducing a Syndicate Control Mechanism:** Most of the industrial sectors are somehow dependent on foreign raw materials. Maximum SME entrepreneurs are unable to import raw materials directly for many reasons. By capitalising on this limitation, a small group of importers import raw materials and charge irrational prices. It makes our products uncompetitive in the international market. For this reason, the government should allow sectoral trade bodies or owners' associations to import raw materials together in a group or introduce a syndicate control mechanism to ensure rational prices for raw materials in the local market.

Most SMEs in Bangladesh today grew on their own initiative. Despite the criticism and neglect of the SME sector on the grounds of inefficiency and non-optimal use of productive resources compared to larger industries, SMEs are beginning to be extolled for their greater dependence on labour-intensive production techniques. It is also necessary to develop SME clusters, and export-oriented SMEs throughout the country to implement Vision-2021 and achieving the middle income status by 2021. As Bangladesh has limited resources to conduct R&D on SME, so replication of the best practices of the SME-enriched countries could be a better mode of learning for Bangladesh. The Bangladeshi SME development authorities may consider replicating best practices of the similar organizations abroad like the cluster-based SME development programme of India, broad-based inclusive financing scheme of Malaysia and South Korea, establishing common service centres, incubation centres, laboratories programmes of Japan, and promoting SME products through organising trade fairs like China and such.



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