

**00252  
BBA**

**Project Report  
On  
“Financing Problems of Small And Medium  
Enterprises In Bangladesh”**

**Course Code: Bus 498**

**Submitted To:**

M Sayeed Alam  
Assistant Professor,  
Department of Business Administration  
East West University

**Submitted By:**

Tabshira Islam  
2007-2-10-045  
Semester: Spring '11

**Date of Submission: 02<sup>nd</sup> May, 2011**



**EAST WEST UNIVERSITY**

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# **Project Report**

**On**

# **“Financing Problems of Small And Medium Enterprises In Bangladesh”**

## LETTER OF TRANSMITTAL

May 02, 2011

M Sayeed Alam

Assistant Professor,

Department of Business Administration,

East West University.

Subject: Submission of Project Paper on "Financing Problem in Small and Medium Enterprises in Bangladesh."

Dear Sir,

It gives me immense pleasure to submit the project on "Financing Problem in Small and Medium Enterprises in Bangladesh" a requirement of the BBA course, East West University.

Apart from the academic knowledge gained this report and preparation of report have given me the opportunity to acquaint myself with the prospects and various problems existing in small and medium business in Bangladesh. I believe that the experience I have acquired from this study will be an invaluable asset in my life.

It expresses my gratitude to you for providing me the opportunity to learn about the prospects and problems of SME in our country. In spite of various shortcomings, I have been devoted to find out the core information from different aspects. I hope you will appreciate my endeavor and find the report up to your expectation.

It has to be mentioned further that without your expert advice and guidance and the contribution of my friends it would not have been possible to complete this project paper.

Thanking you

Tabshira  
Tabshira Islam

ID:2007-2-10-045

Department of Business Administration

East West University.

## **ACKNOWLEDGMENT**

First of all I would like to thank the Almighty Allah for blessing me to complete the report on safe and sound mind.

A great deal of gratitude to the course teacher M Sayeed Alam ,Assistant Professor, Department of Business Administration, East West University. He offered me continuous guidance and many insignificant and constructive observations throughout the study. Basically his support, encouragement and availability to discuss ideas and problems have contributed much in completing this report.

I would like to thank the business owners I have interviewed for their cooperation in successfully completing my survey. I am thankful to our friends, classmates who helped me to complete this report. After all, my deepest gratitude to the Almighty Allah for giving me courage and ability to complete this task.

## EXECUTIVE SUMMARY

Small and Medium Enterprise (SME) Financing is a topic of significant research interest to academics and an issue of great importance to the policy makers around the world. Economic, as well as technical and social arguments warrant the promotion of SMEs, as they create large scale, low-cost employment opportunities, use locally available inputs and technologies, mobilize small and scattered private savings, develop entrepreneurship, and correct the regional imbalance in development that exists in developing countries. Despite all these potentials, SMEs are disappearing, abandoning the potential role they could have played in economic development. Several studies have identified the major obstacles that include, but not limited to, financing, infrastructure facilities, taxes and regulations and stability in policies. To make an overall view on small business prospects in Bangladesh I survey on small business operating in Bangladesh usually. To make a successful and efficient report I made a questionnaire and went to the respective person who are basically the owner of such small business or strongly related to that specific business. Some of our surveyed sectors are grocery shop, candle business, Laundry shop, boutique shop, beauty parlor, restaurant, printing press etc. Using the collected information I have analyzed the small business market in the sector as a whole. This has given us a well defined present scenario of small business including the problems and prospects of such type of business sectors. Based on these prospects and problems I have tried to give some recommendations on this business arena. This paper focuses on the financial constraints in Bangladesh. Moreover, it tries to emphasize on the importance of developing SMEs in the country as well as the obstacles the entrepreneurs are facing in shaping their ventures mainly in accessing the institutional credit facilities. In Bangladesh, among the formal sources, commercial banks are not interested because of the high risk and high supervision cost associated with this type of financing. Absence of sound collateral puts SMEs at a relative disadvantage. However, I have found that some of the commercial banks have some 'innovative' products or services targeting at SMEs only, while others have 'repackaged' some of their existing products as SME products. It has been observed in the study that commercial banks disburse loans to this sector only when government introduces 'credit guarantee scheme' in different capacity.

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# **Chapter 1**

## **Introduction**

# **1. Introduction:**

## **1.1 Origin of the Report:**

In recent days the Small and Medium Enterprise (SME) Financing has become an important area for Commercial Banks in Bangladesh. To align its corporate policy with the regulation of Central Bank, banks have become more concerned about SME and opened windows to conduct business in this particular area. This study has been conducted to fulfill the requirements of the BBA course and gain an insight about the present condition of small and medium enterprises in the economy of Bangladesh and their financing scenario.

## **1.2 Background of the Study:**

After Liberation of Bangladesh, intensive efforts were undertaken to accelerate the rate of industrialization in the country. At the beginning, import substitution and subsequently export-led economic growth strategy was pursued for industrialization. In order to attain this objective, large amount of industrial credit was funneled to the industrial sector. But the whole exercise of industrialization came to a halt with the massive diversion of resources to other non priority sectors. Policy makers, of late, have come to recognize the contribution of SME sector towards economic development in the country. Small and medium enterprises have been recognized as one of the most important means for providing better economic opportunities for the people of least developing countries like Bangladesh. A developing economy like that of ours suffers from many peculiar problems such as disproportionate pressure of population on agriculture due to lack of rural industrialization, unemployment and underemployment of human and materials resources, unbalanced regional development etc. The contribution of small and medium enterprises in the solution of these problems is beyond doubt, provided they are organized and run on scientific basis.

Small and medium enterprises are particularly suitable for densely populated countries like Bangladesh where SME sector can provide employment with much lower investment per job provided. Out of 11% employment of the civilian labor force provided by the manufacturing sector, about two thirds are estimated to be provided by the small and cottage industries sector.



Again, development of small industries facilitates the effective mobilization of capital and labor resources. They also help in raising standards of living of people in rural areas. Contribution of SME sector to GDP remained above 4% during the period from 1985-86 to 1999-00. Moreover, the present contribution of SME sector to GDP is approximately 5% and SME sector employs 25% of the total labor forces, thus this sector is the present available sector for creation of jobs .

The policy environment within which SMEs in Bangladesh operate accompanies legal, regulatory and administrative constraints to employment creation by SMEs. The robustness of SME contributions to employment generation is a common phenomenon in most developing countries in that the magnitude varies between 70% to 95% in Africa and 40% to 70% in the countries of the Asia-Pacific region.

Liberalization of industrial and trade regimes along with globalization are likely to have had significant effects on Bangladesh's SMEs. Various recent studies (ADB 2001, USAID 2001) show that SMEs have undergone significant structural changes in terms of product composition, degree of capitalization and market penetration in order to adjust to changes in technology, market demand and market access brought by globalization and market liberalization. The official data show that the share of private investment in Bangladesh's GDP in the late 1990s, which may be considered as the post-reform era, has remained more or less constant at around 15%. This may be interpreted as an evidence of stagnant private sector activities in the country.

The recent private sector survey estimates the contribution of the micro, small, and medium enterprises (MSMEs) is 20-25% of GDP. While SMEs are characteristically highly diverse and heterogeneous, their traditional dominance is in a few industrial sub-sectors such as food, textiles and light engineering and wood, cane and bamboo products. According to SEDF sources quoted from ADB (2003), food and textile units including garments account for over 60% of the registered SMEs.

Despite these contributions in the economy of the country, Banking sectors are not interested in financing the small and medium enterprises; rather there is a decline in the amount of advances by the Banking sector. There are approximately 52 Banks operating in our country and all are

erving large enterprises rather than SMEs though only the small enterprise's contribution is 5% in GDP of Bangladesh in 2007.

### **1.3 Objectives of the Study:**

- Learning about the existing small and medium business in Bangladesh
- Exploring the present scenario of SME sector in Bangladesh.
- Identifying funding sources of SME financing
- Finding out the constraints of financing small business.
- Observing real life situation of small business by conducting survey
- Finding and analyzing the problems faced by those business
- Providing policy recommendations to boost SME sector in Bangladesh



### **1.4 Methodology of the Study:**

This report has been prepared on the basis of collection of information from both secondary sources and primary data collection survey. The data are purposively selected and only for the use of preparing this report.

#### **1.4.1 Primary Data:**

I have collected primary data in the following way:

- ✓ Face to face interview with both employees and owners of small business
- ✓ Observing the organization

#### **1.4.2 Secondary data:**

The study was conducted mainly based on secondary information although some information relating to entrepreneurs have been collected primarily. The sources of secondary data are as follows:

- ✓ Information collected from related books

- ✓ Information collected from prior research of Bangladesh Bank, Bangladesh Enterprise Institute (BEI), Centre for Policy Dialogue (CPD), International Finance Corporation (IFC) etc.
- ✓ Information collected from Internet.

### **1.5 Limitations of the Study:**

- Discussion about the Small and Medium Enterprises is a vast subject, but only some selected areas are covered in the project report.
- The study is basically based on secondary data.
- In many cases, up to date information is not published
- All the comments made, conclusions reached and suggestions for possible improvement provided are purely based on my level of understanding, knowledge and my way of interpreting a particular statement.

## **Chapter 2**

# **Current Status of SMEs in the Economy**

## **2. Current Status of SMEs in the Economy:**

### **2.1 Brief Macro-economic Review:**

Bangladesh, mainly backed by the growth of manufacturing, construction and service sector has achieved a year-upon-year GDP growth of 6.51% in 2006-07, as compared with the 6.63% in FY 2005-06, and 5.38% in 2004-05. Per capita GDP recently surpassed \$500. From 1% during the 1970s, growth rate of GDP per capita has ramped up to over 3% since the early 1990s and, since 2003-04, even higher, to 4 off percent. Growth has been more stable too; Bangladesh among the handful of countries that sustained positive per capita growth in each year since the early 1990s. This performance has been underpinned by rising agricultural and non-farm rural output and a rapid expansion in export of readymade garments (RMG).

Faster economic growth has helped Bangladesh to reduce the poverty rate by about 1 (one) percentage point per year since 1990. Poverty fell from 60% in 1990 to 50% in 2000. Although the latest poverty data are still being collected, proxy indicators suggest that good progress on poverty reduction and social development has continued in recent years. Many MDGs are also on track for being met. (World Bank 2005)

The rate of gross investment in GDP in 2007-07 is 24.33%. The relative share of private sector in gross investment, which has been growing secularly, is 18.73% in 2006-07. Between 2005-06 and 2006-07, credit to the private sector grew by 11.2%. The population growth rate averaged 1.5% or so; the literacy rate has averaged at 62% during this decade.

Growth rate of manufacturing output of Bangladesh is on an increasing trend. Manufacturing growth during 1992-96 averaged 8.21%. In the next four years, the corresponding growth averaged more than nine percent annually. Service sector grew at an average rate of 4.9%, which is lower than that of industries (manufacturing) sector. The quantum index of SMEs has grown by 5.4%. The export of readymade garments (RMG) both woven and knitwear has picked up a commendable mode of growth, which earns over 76% export earnings.



## 2.2 Current status of small and medium enterprises in Bangladesh:

The Small and Medium Enterprises worldwide are recognized as engines of economic growth. The commonly perceived merits often emphasized for their promotion especially in the developing countries like Bangladesh include their relatively high labor intensity, dependence on indigenous skills and technology, contributions to entrepreneurship development and innovativeness and growth of industrial linkages.

### 2.2.1. Definition:

According to the latest circular of BANGLADESH BANK (Date – 26/05/2008), the definition of Small & Medium Enterprise sector is given below:

**2.2.1.1 Small Enterprises** – Small enterprises refer to those enterprises which are not any Public.

Limited Companies and which fulfill the following criteria-

**Service Concern-** Having an investment of Tk. 50,000 to Tk. 50, 00,000 excluding land & building and / or employing up to 25 workers.

**Business Concern** - Having an investment of Tk. 50,000 to Tk. 50, 00,000 excluding land & building and / or employing up to 25 workers.

**Manufacturing Concern** - Having an investment of Tk. 50,000 to Tk. 1,50,00,000 excluding land & building and / or employing up to 50 workers.

**2.2.1.2 Medium Enterprises** – Medium enterprises refer to those enterprises which are not any Public Limited Companies and which fulfill the following criteria-

**Service Concern-** Having an investment of Tk. 50,00,000 to Tk. 10,00,00,000 excluding land & building and / or employing up to 50 workers.

**Business Concern** - Having an investment of Tk. 50,00,000 to Tk. 10,00,00,000 excluding land & building and / or employing up to 50 workers.

**Manufacturing Concern** - Having an investment of Tk. 1,50,00,000 to Tk. 20,00,00,000 excluding land & building and / or employing up to 150 workers.



SMEs in Bangladesh are also defined for purposes of industrial policies by Ministry of Industries (MOI). Historically, this definition has been in terms of fixed investment brackets, and a dual mode definition is in place, separate for manufacturing establishments, and service establishments.

According to the Industrial policy 2005, small and medium enterprises shall be categorized using the following definitions:

#### **2.2.2.1. Manufacturing enterprise:**

**2.2.2.1.1. Small enterprise** – an enterprise should be treated as small if, in current market prices, the replacement cost of plant, machinery and other parts / components, fixtures, support utility, and associated technical services by way of capitalized costs (of turnkey consultancy services, for example), etc, excluding land and building, were to be up to tk. 15 million.

**2.2.2.1.2. Medium enterprise** - an enterprise would be treated as medium if, in current market prices, the replacement cost of plant, machinery and other parts / components, fixtures, support utility, and associated technical services by way of capitalized costs (such as turnkey consultancy services), etc, excluding land and building, were to be up to tk. 100 million.

#### **2.2.2.2 Non-manufacturing enterprise:**

**2.2.2.2.1. Small enterprise** – an enterprise should be treated as small if it has less than 25 workers, in full time equivalents;

**2.2.2.2.2. Medium enterprise** - an enterprise would be treated as medium if it has between 25 and 100 employees.

## 2.2.2. Overview of the SMEs in the economy of our country:

There is a great interest in small and medium enterprises (SME) as a major plank of poverty reduction in Bangladesh. The government has formulated a comprehensive industrial policy 2005 by putting special emphasis for developing SMEs as a thrust sector for balanced and sustainable industrial development in the country to help deal with the challenges of free Market economy and globalization.

Some data with a national scope those are pertinent to characterizing SMEs in Bangladesh as of 2001-2003 are presented in Table – 1. The highlight of this table is the following:

There are some 78,440 private sector establishments of various sizes in Bangladesh with some 3.5 million workers employed in them. The urban Bangladesh accounts for some 60% of units and 76% of employment in the private-sector enterprises. Rural Bangladesh accounts for the rest. 93% of all units in Bangladesh belong in the SME category, i.e. have between 20 and 99 employees. However, SMEs account for only 44% of the total employment of the enterprise sector.

Private companies limited by liability account for strictly a very small proportion of the total number of SMEs in Bangladesh.

### Number of units and levels of employment in small and medium enterprises, 2001/2003

(All numbers are in thousands)

Des- Crip- Tions	Urban			Rural			Total		
	Small	Me diu m	Large	Small	Medi um	Large	Small	Medi um	Larg e
No. of Units	39.9	3.17	4.036	29.0	1.29	0.88	68.96	4.46	5.01
% of total number of units	50.9	4.0	5.1	38.1	1.6	1.11	87.9	5.7	6.4

Employment	740.4	211.5	1712.67	516.8	85.85	234.69	1257.2	297.4	1947.3
% of total employment	21.14	6.0	48.9	14.8	2.4	6.7	35.9	8.5	55.6

Table 1:Source: BBS Census of Enterprises, 2001/2003

Table – 2 shows the average employment per establishment within each of the small and medium classes for urban and rural Bangladesh in 2001/2003. The following results are worth highlighting. Let it be noted that these are weighted averages. First, the average employments per establishment for small establishments have values of between 17 and 20 workers across all industries. I find a similar a narrow range of between 65-69 employees for average employment size for medium enterprise.

#### Average head-count per establishment across Bangladesh's industries, 2001/2003

	Small	Medium	SME	Large	All
Food and tobacco	18.6	65.1	21.0	470.5	38.9
Textile manufacturing	19.1	66.2	21.9	490.9	56.6
Ready-to-wear apparels	17.8	70.3	22.9	512.7	249.6
Wood, leather & paper printing	17.0	66.8	19.7	373.9	38.0
Chemicals and	19.1	67.0	22.7	367.2	58.0

Plastics					
Non-metallic mineral products	26.0	70.3	41.5	196.8	83.4
Fabricated goods, electricals and means of transport	17.0	65.7	20.3	282.5	35.1
Mining and manufactures	24.6	65.5	32.7	227.7	58.9
Various personal services	17.5	66.0	19.9	293.3	28.2
Education/healthcare	18.1	65.5	20.3	292.4	26.7
All industries	18.2	66.7	21.2	388.5	44.6

Table 2: Source: BBS Census of Enterprises, 2001/2003

Table – 3 shows the percentage importance (in terms of both number of units and the employment level) of SMEs in the overall world of enterprises. The numbers of SME units predominate the numbers of large enterprises: typically more than 90% of all enterprises are in the SME class-class. However, the percentages share of SMEs in total employment controlling for the location is almost always less than for the number of units.

The structure of “industries” in Bangladesh with respect to size of firms, 2001/2003

	% of establishments			% of total persons employed		
	Small	Medium	Large	Small	Medium	Large
Food and tobacco	6.7	0.4	.03	2.8	0.5	3.1
Textile manufacturing	14.2	0.9	1.2	6.0	1.3	13.2
Ready-to-wear apparels	1.8	0.2	1.7	0.7	0.3	20.1
Wood, leather & paper printing	2.9	0.2	0.2	1.1	0.2	1.4
Chemicals and Plastics	1.7	0.1	0.2	0.7	0.2	1.7
Non-metallic mineral products	1.6	0.9	0.9	0.9	1.3	4.0
Fabricated goods, electricals and means of transport	4.3	0.3	0.3	1.6	0.5	1.7
Mining and manufacture nes	0.2	..	..	0.1	0.1	0.2
Various personal services	23.6	1.2	0.8	9.3	1.8	5.1
Education/healthcare	31.1	1.5	0.8	12.6	2.2	5.2
All industries	87.9	5.7	6.4	35.9	8.5	55.6

Table 3: Source: SME Cell, using data from BBS Census of Enterprises, 2001/2003

Table – 4 show that the relative importance of SMEs, both in terms of numerical importance of establishments or employment, in the context of all enterprises with employment size of exceeding 9 workers remains roughly similar across an urban-rural divide. The role of SMEs in production is therefore not affected by geography.

**Proportion of SMEs in enterprise population, and in employment, by administrative**

**Divisions of Bangladesh, 2001/2003.**

<b>Divisions</b>	<b>Urban (% of SMEs in the number of urban units)</b>	<b>Urban (% of SMEs employment in urban areas )</b>	<b>Rural (% of SMEs in the number of rural units)</b>	<b>Rural (% of SMEs employment in rural areas)</b>
Dhaka	93.8	61.2	95.6	65.3
Chittagong	93.7	54.2	92.4	69.1
Rajshahi	95.3	65.9	97.9	81.3
Khulna	93.8	59.1	95.8	70.5
Sylhet	96.6	68.6	91.9	41.5
Barisal	95.7	69.4	97.8	82.7
All divisions	94.8	63.1	95.2	68.4

Table 4: Source: BBS Census of Enterprises, 2001/2003

Table – 5 shows the percentage structure of small and medium enterprises, taken separately, across a large number of industries. Like in the discussion of Table – 3, again the quantitative importance of food, beverage, textile manufacturing, non- metallic mineral products among manufacturing sub-sectors as providing the basis for small and medium enterprises in Bangladesh. Once again, the importance of services is highlighted.



**Industrial structure of small and medium enterprises in Urban and Rural Bangladesh,  
2001/2003**

Sectors	Proportion of small enterprises in the total		Proportion of medium enterprises in the total	
	Rural enterprises	Urban enterprises	Rural enterprises	Urban enterprises
Mining	0.4	0.2	1.2	1.0
Food & tobacco	16.6	9.3	7.4	9.0
Textiles MFG	58.7	8.4	29.2	17.5
Wearing apparels	0.3	4.6	1.0	3.3
Wood products	0.2	2.6	.4	1.8
Tanning, etc	1.1	0.8	.1	0.2
Paper & printing	0.1	3.3	.4	3.4
Chemicals & plastic	0.4	4.2	.7	4.6
Non-metallic mineral pr.	6.1	1.1	47.9	3.1
Fabricated products	0.7	3.9	.6	5.8
Electrical equipment	0.0	0.7	.2	0.7
Mfg. Transport equipment	1.6	0.5	.9	0.7
Utility services	0.2	5.0	1.9	3.0
Construction	0.1	0.5	.6	1.8
Trade	2.4	4.9	.5	4.4
Eateries	1.4	7.1	.3	5.2
Transport & Comm	1.2	22.0	2.8	7.6



Finance & Banking	8.4	16.9	3.8	13.5
Real Estate	0.2	3.9	.3	7.5

Table 5: Source: BBS Census of Enterprises, 2001/2003

### 2.2.3 Contribution of SMEs in the Economy:

In view of present economic development effort in Bangladesh the SME sector plays an important role. These are reflected in the following performance /activities of this sector:

- During the Fourth Five year plan, a total of 0.35 million jobs were created against the target of 0.4 million.
- Contribution of SME sector to GDP remained above 4.5% during the period from 2000-01 to 2004-2005 despite decline in the amount of advances by the banking sector to this sector.
- SME sector employs 25% of the total labour force. As a result, this sector is the present available sector for creation jobs.
- SME sector help alleviate poverty, increase income level of rural people and promote agro-industrial linkage in Bangladesh.
- SME sector requires lower energy supply, lower infrastructure facilities and this sector imposes less environmental risk.
- They contribute towards better utilization of local resources and skills that might otherwise remain unutilized.
- Small industries being labour oriented are capable of generating more employment.
- They are necessary to maintain and retain traditional skills and handicrafts.
- They are the only medium for diversification of rural economy and for peaceful and concurrent socio-economic development of all classes of people.
- From the above discussion, I can say that SMEs are playing an important role in our economy in various ways.

**Chapter 3**  
**Current Status of SME**  
**Financing by Banks in**  
**Bangladesh**

### **3. Current Status of SME Financing by Banks in Bangladesh**

#### **3.1. Current Status of SME Financing by Banks in Bangladesh:**

The NCBs are disbursing significant amount of credit under various programs like Small Enterprise Development Project, Self-help Credit Program, Projects for Small Entrepreneurs, Special Investment Program and Agro-based Supervisory Industrial Credit etc. for the promotion and development of SMEs. The investment of private sector banks in financing SMEs remains insignificant in Bangladesh. Of all the private sector banks, BRAC Bank, Eastern Bank Ltd. (EBL), Prime Bank Ltd, Dhaka Bank Ltd, Mercantile Bank Ltd, Dutch-Bangla Bank Ltd, Islami Bank Bangladesh Ltd, IFIC Bank Ltd. have the leading role in SME financing. Bank of Small Industries and Commerce Bangladesh Ltd. (BASIC) is entrusted with the responsibility of providing medium and long-term loans for promotion and development of small-scale industries. The memorandum and Articles of Association of the bank stipulates that 50% of loan able funds shall be used for financing small scale and cottage industries. The outstanding credit of BASIC stood at Tk158.9 crore at the end of December 2001 for small and cottage industries sector that rose to Tk178.7 crore by 12.46% at the end of December 2002.

Table-6 gives an idea of the role of small and medium enterprises as destinations for bank credit in 2004 and 2005. Bangladesh's classification of bank advances lumps medium enterprises with the large enterprises, while small units are lumped with cottage-based units. As such, unfortunately, it is not possible to speak of the access to finance issues for SMEs per se. We know however separately that SCIs corresponds to more than 99% of all productive establishments in Bangladesh.

Out of 3.8 million establishments of all kinds in Bangladesh, only 10,798, or just about 0.3% happen to fall in either medium or large establishment size class based on employment size. The percentage is even much lower in manufacturing or trade---the two sub-sectors from which the case studies in this paper are drawn. And yet, such staggering smallness of the proportion of medium and large establishments is coupled with a preponderance of large and medium enterprises in total credit disbursements from the banking system. It is quite safe to assume that



of total credit disbursed to large-and- medium class, an overwhelming majority ---perhaps, 80% or so---is arrogated by large establishments. It becomes quickly clear that SMEs, for all their numerical superiority among establishments, receiving bank credit is the exception and not the rule.

Why is the access to finance for the SMEs in Bangladesh not even based on neutral ground, not to speak of rosy or good? This is because the issue of bank credit is based on the ownership of collateral: bankers insist on immovable property for collateral. Only about 15-20% of the owners of SMEs own any immovable property at all in which the bankers are interested. This automatically excludes about 80% of SMEs from being among the privileged client of a bank loan.

**Percentage distribution of advances made by PCBs, FCBs and NCBs in 2005 and 2004: By receiving sectors**

(Numbers are percentages; last row shows the disbursements in Tk. crores)

<b>Name of Sectors and type Of financing</b>	<b>Private Commercial Banks, 2005</b>	<b>Private Commercial Banks, 2004</b>	<b>Foreign Commercial Banks, 2005</b>	<b>Foreign Commercial Banks, 2004</b>	<b>State Commercial Banks, 2005</b>	<b>State Commercial Banks, 2004</b>
Agriculture	0.8	0.6	0.1	0.1	56.7	10.8
Large & Medium industry	14.0	11.4	10.9	11.1	17.9	21.1
SCI	0.7	.6	.6	.6	.9	1.1
WC large/mediu	17.2	14.4	27.2	26.3	7.1	17.9

m industry						
WC for SCI	.9	.7	1.4	1.3	.4	.9
Construction	8.7	15.7	0.9	0.8	1.6	6.7
Transportation	1.8	7.8	2.2	1.0	0.2	0.8
Storage	0.2	1.6	0.0	0.0	3.0	1.3
Trade financing	46.6	39.0	24.9	21.2	7.7	30.2
Miscellaneous	9.1	8.2	31.7	37.6	4.6	9.3
Total	100.0	100.0	100.0	100.0	100.0	100.0
Total advances	53029	40298	7819.8	6629	10637	37662

Table 6: Source: All estimates are based on trade estimates, and not based on detailed survey(s)

Note: SCI stands for small and cottage industry; WC stands for working capital

In Bangladesh, some banks have come forward to finance SMEs for their development, but many of them do not have good experience regarding loan servicing in this sector. Small and cottage industry credit position in overall industrial credit of Sonali Bank has been shown.

**Small and Cottage Industry Credit Position in overall industrial credit of Sonali Bank as  
on 2003**

(Taka in core)

	<b>INUSTRY</b>	<b>SMALL&amp;COTTAGE INDUSTRY</b>	<b>SCI CREDIT AS% OF IC</b>
Sanctioning	1858.56	523.08	28.14
Disbursement	1258.57	456.68	36.28
Recoverable	1121.85	556.68	49.62
Recovered	427.84	220.12	51.44
Overdue	694.01	336.56	48.49
Outstanding	2260.00	685.39	30.32

Table-7: Source: Bari, M.A. & Jamal, Sabera A. Reading material of the course on Financing  
of SME, BIBM

From the above table, it found that the recovered amount of credit is very low i.e. the recovery rate of disbursement is very poor. Small and Cottage Industry sector is facing a huge overdue of credit that are disbursed to this sector.

Scheduled banks in Bangladesh continued to provide credit to the small-scale industrial sector. But it is evident that deployment of resources in large and SME sector in the recent years is disproportionate compared to their relative contribution to GDP.

Table – 8: It shows that deployment of bank credit to large industries increased gradually from 32.40% of total advances in 2000-01 to 39.60% of total advances in 2004- 05. But advances to Small industries rose very slightly from 1.70% to 2.00% although contribution of Small industry sector to GDP remained well above 4.5% during the same period.

### Contribution of industries in GDP and their relative financing by Banks

Year	Contribution of industry to GDP	Contribution of large scale industry to GDP	Contribution of small scale industry to GDP	Scheduled banks advances to industry	Scheduled banks advances to large scale industry	Scheduled banks advances to small scale industry
2000-2001	15.40	11.06	4.54	34.10	32.40	1.70
2001-2002	15.90	11.41	4.51	34.90	33.20	1.70
2002-2003	16.60	12.04	4.56	36.10	34.30	1.80
2003-2004	17.10	12.51	4.59	38.40	36.50	1.90
2004-2005	17.80	13.19	4.61	41.60	39.60	2.00

**Table-8:** Source: Scheduled Bank statistics, Bangladesh Bank different issues, Economic survey, Ministry of finance, Govt. of People Republic of Bangladesh, different issues, SME Foundations.

Table-9: shows that outstanding advances by Denationalized Commercial Banks (DNCBs) depicted a rising trend. The following table shows the amount of outstanding advances of DNCBs during the last few years.

**Amount of outstanding advances of DNCBs during the last few years**

	Sonali Bank			Janata Bank			Agrani Bank			Rupali Bank		
	2006	2007	2008*	2006	2007	2008*	2006	2007	2008*	2006	2007	2008*
Industrial Sector	4053	3321	1801	2341	2954	1308	2042	2137	1151	582	5251	3518
Large & medium industry	3150	2531	1288	2327	2912	1300	1531	1298	600	564	5219	3507
Small & cottage industry	903	790	513	14	42	8	511	839	531	18	32	11

Table 9:Source: Resume of Activities Of Banks and Financial Institutions, Ministry of Finance, Govt. of Peoples Republic of Bangladesh, different issues.



# **Chapter 4**

## **Constraints facing by SME in finance sector**

#### **4. Constraints facing by SME in finance sector**

Despite the fact that small and medium enterprises (“SMEs”) constitute a vital sector of the economy of Bangladesh in terms of creation of industrial output and generation of employment (SMEs of Bangladesh account for almost 82% of the total industrial labor force and share nearly 35% of the gross output of the entire manufacturing sector), they face a severe crisis of capital for their growth and development. A most recent private enterprise survey reveals that 58% of the SMEs suffer from a lack of investment funds and 35% suffer from a lack of operating funds in Bangladesh. Another recent survey conducted by the Bangladesh Garment Manufacturers and Exporters Association (BGMEA) in Dhaka city in 2003 reveals that 53% of the Readymade Garment (RMG) businesses, which is a vital part of SME sector, receives only working capital from banks whereas 28% of them do not receive any financial supports. SMEs relating to the export sector also have the problem of accessing working capital and there is no credit insurance policy for them. These situations have created an interest in identifying available sources of finance for SMEs in Bangladesh as well as examining any alternative options for catering their financing and non-financing needs. Broadly, sources of finance for SMEs in Bangladesh can be categorized into three major groups. They are the ‘banking sector’, the ‘non government organizations’ (“NGOs”) and informal players like money lenders, friends, relatives, “samity”, unregistered cooperatives and so on, and the ‘capital market’ of Bangladesh. As it is elaborated in the following section, these players (banking system, capital market and NGOs along with informal players) point to the gap within the existing financial system of Bangladesh for catering to the financing needs of the SMEs, specially those that are not backed by collaterals and do not have a minimum asset base as well as a history of operation.

It is generally observed that NGOs basically provide finance in the range of US\$100 to US\$3500 and institutionally speaking, are unable to provide large loans. Besides, the capital market requires a minimum asset base, which the entrepreneurs of SMEs cannot offer. Finally, the banking system is burdened with high NPLs, moral hazards and incentive problems and prefers to provide credit under certainty and as such prefers collateralized lending. However, those entrepreneurs who graduated from the micro level to small and medium enterprises and require credit in the range of ‘US\$15000 to US\$30000’<sup>5</sup>) for their expansion and growth, generally lose

out on the attention from all markets. They are popularly known as ‘missing middle’ in the country. *The basic purpose of this paper is to explore avenues to fill this gap of financing.* Figure 1 illustrates this gap.

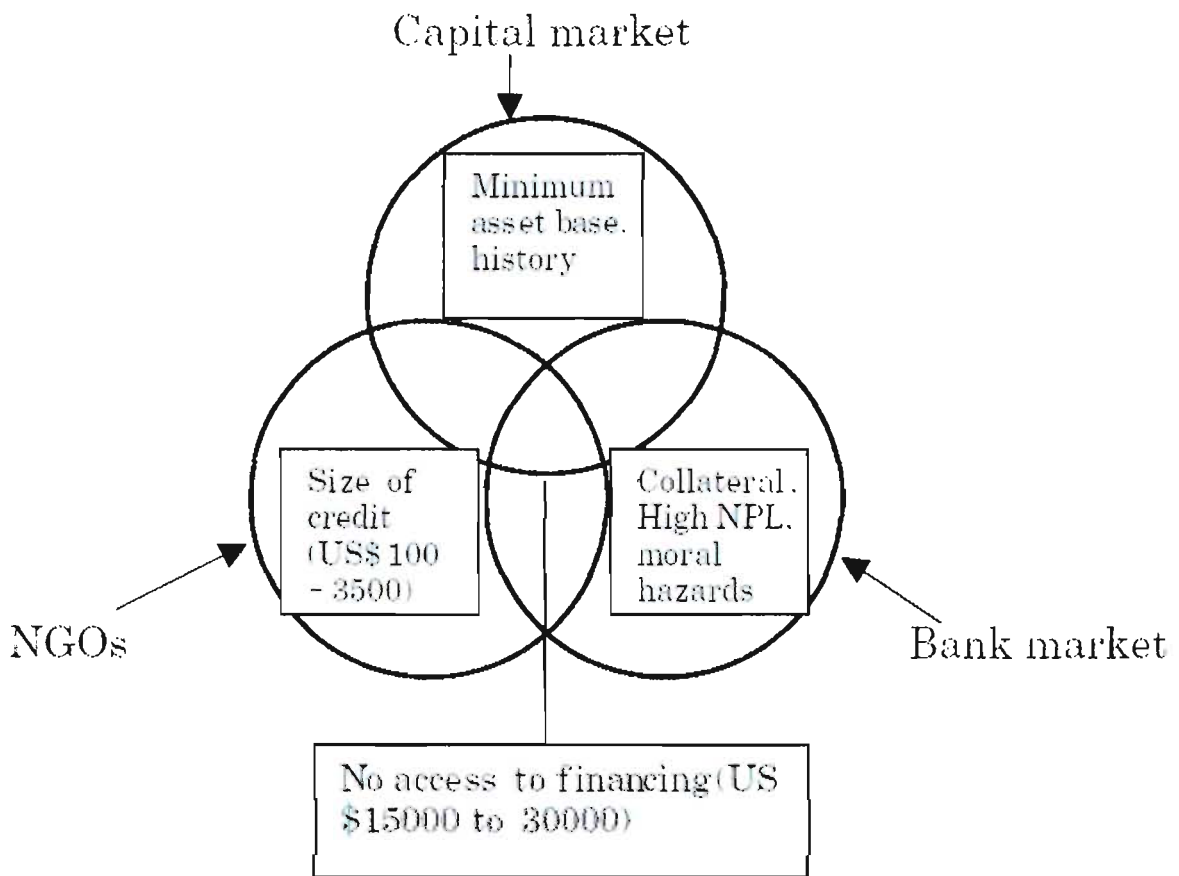


Figure1: Barriers to financing SMEs.

Can we rely on the banking system of Bangladesh to fill this gap? In fact, the banking system of Bangladesh accounts for 72% of public deposits and is a pre-dominant player within the financial system and consequently they should take the responsibility. Or, can we ask the NGOs to come forward? In fact, NGOs successfully disburse micro credit in the rural financial markets of Bangladesh with a high loan recovery performance (more than 90% on an average). Or, can we bank on the capital market of Bangladesh to take care of the SMEs? Or, should we develop an additional financial intermediary to fill this gap in financing?

The assumption is that in the present economic scenario of Bangladesh, it might be difficult for these players (banking system, capital market and NGOs) to successfully cater to the financing and nonfinancing needs of SMEs.

#### **4.1 Analysis of the Structure of the Financial System of Bangladesh:**

The financial system of Bangladesh encompasses Bangladesh Bank (BB) as its central bank, four (4) nationalized commercial banks (“NCBs”), thirty (30) private commercial banks (“PCBs”), ten (10) foreign commercial banks (“FCBs”), five (5) government owned specialized banks (“SBs”), and twenty eight (28) non-bank financial institutions (“NBFIs”). The NBFIs include specialized institutions (“SIs”) like house building finance corporations, the investment corporation of Bangladesh, leasing and finance companies, government cooperatives and ‘specialized public institutions (“SPIs”) like the post office savings scheme (figure 3).

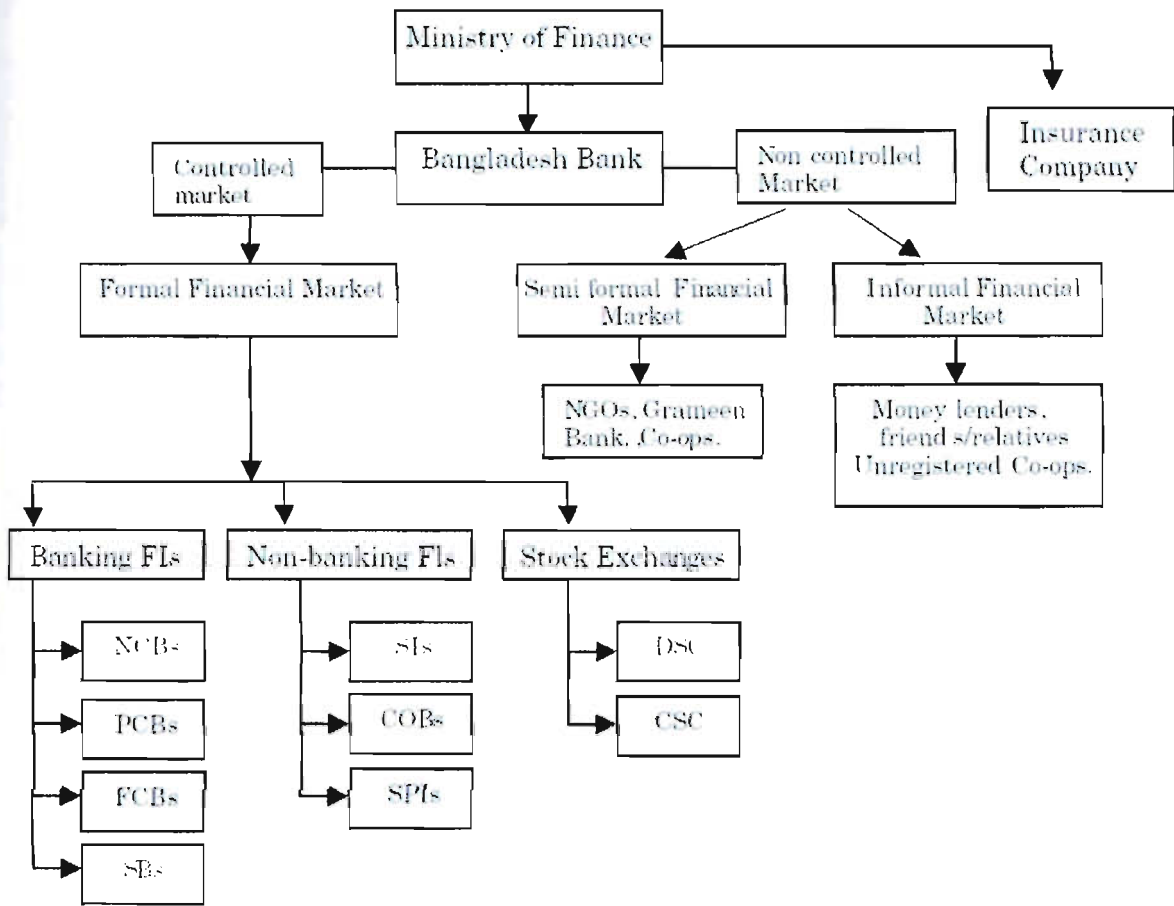


Figure 3: Financial System of Bangladesh

All these institutions mainly play in the ‘formal financial market’ and are controlled by Bangladesh Bank. The financial System also embraces 49 insurance companies and 2 stock exchanges (figure 3). There are also more than 3000 NGOs and a large number of registered cooperatives that play a significant role in the semi-urban and rural financial markets of Bangladesh. They are popularly known as ‘semi-formal’ as they have their own rules and regulations and are not controlled by Bangladesh Bank or by the Ministry of Finance. They are guided by the Societies Act 1861, which does not permit them to conduct business activities. Besides, there is an informal market, which is mainly dominated by friends, relatives, money lenders and non-registered cooperatives, and they do not have any formal rules and regulations. Obviously, they are outside the purview of any controlling body (figure 3).

In the formal market, Bangladesh Bank, as the central bank, performs the traditional central banking role of note issuer and act as a banker to the government and all commercial banks. It formulates and implements monetary policies, manages foreign exchange reserves and supervises all banks and non-bank financial institutions. Its prudential regulations include minimum capital requirements (Tk.1000 million for setting up a new bank), capital adequacy (9% of the risk weighted assets), limits on loan concentration and insider borrowing, CAMEL rating, guidelines for asset classification and income recognition etc. The transparency and accountability of the stock market is usually maintained by the Security and Exchange Commission in collaboration with Ministry of Finance and Bangladesh Bank.

#### **4.2 Constraints of the Financial System of Bangladesh (Banking Sector):**

Banking systems of developing countries mainly channel funds to deficit sectors as stock market usually suffers from solid base of private investors followed by questionable transparency and accountability. However, the banking system in the developing countries does not practice a deposit insurance system and depositors deposit their money in a particular bank solely on the basis of 'trust'. Therefore, it is the basic philosophy of the banking business to protect this trust by not allocating the depositor's money to risky ventures. This implies that bankers by nature cannot afford risky ventures thereby preferring collateralized lending. On the other hand, SME financing is incompatible with the philosophy of the banks as it increases transaction costs and moral hazards. Figure 2, shown below, presents characteristics of SMEs and Banks and exhibits a 'strategic mismatch' situation in terms of their inherent characteristics. The strategic mismatch situation arises because banks are regarded as passive investors, as opposed to active investors, which is an essential prerequisite for SME financing. Therefore, theoretically, I can pre-suppose that that bankers' cannot extend credit to enterprises which have uncertain futures - (SMEs), as this might destroy important yardsticks like confidence, trust, reputation and robustness within the sphere of banking operations.

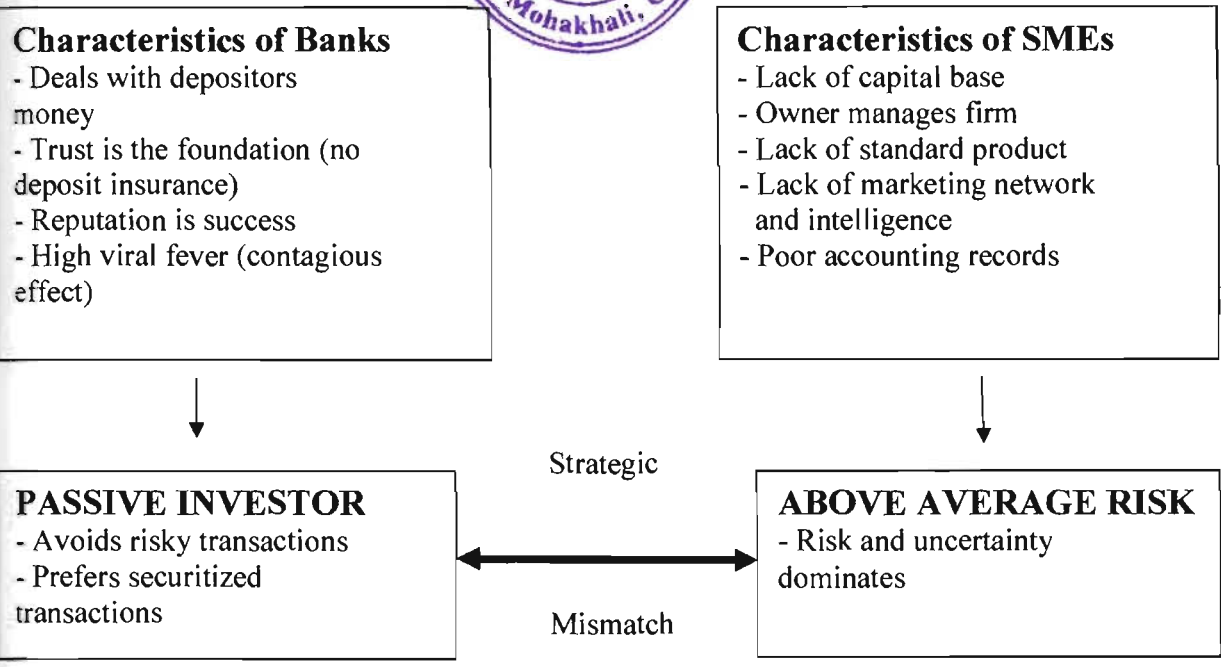


Figure 2: Strategic mismatch of SME financing

#### 4.2.1 Present lending behavior of the bank:

The present lending behavior of the banking system in Bangladesh is based on collateral. Bankers want to avoid ‘uncertainties’ as well as ‘credit crunch’. Among many reasons, the huge amount of non-performing loans (13.56% in 2005; Annual Report 2005-2006, Bangladesh Bank) with a very low percentage of return on assets (0.6% in 2005; Annual Report 2005-2006, Bangladesh Bank) make it mandatory for policy makers to direct all their efforts to curbing non-performing loans (“NPLs”) by way of transferring risks to bank officials. This situation, in fact, has compelled bank officials to extend credit only under ‘secured circumstances’ ensuring enough tangible securities to be held as collateral. Since most SMEs are characterized by uncertainties and lack tangible assets (that they pledge to banks as collaterals), they are usually deprived of receiving finance from banks in Bangladesh. This fact is observed from various studies and micro surveys relating to SMEs in Bangladesh. In most cases banks and non-bank financial institutions of Bangladesh require collateral, almost twice the amount of requested

loans, in the form of land and buildings in lieu of getting loans by large enterprises as well as SMEs. SMEs are also regarded as high risk borrowers by bank officials because of their low capitalization, insufficient asset base and high mortality rates and consequently, they are not offered any attractive deals in terms of loans and interest rates. Banks are further seen to be conservative in nature in lending to SMEs, as they do not consider them as attractive and profitable undertakings.

Importantly, the SAPRI SME survey (1999) has revealed a bunch of factors (barriers) both on the demand side (borrowers' perception) and supply side (bankers' perception) that hinder the growth and development of SMEs in Bangladesh. On the demand side, the report (SAPRI SME survey, 1999) mentions that 79.4% of SME borrowers face collateral problems in obtaining credits from different commercial banks. The second most problem they face is bribe (66%), which actually increases their cost of funds. They also face problems in certain other factors like delay in getting loans (54.6%), high interest rate (39.2%) disinterest from the part of banks (27.8%), requirement of guarantees (27.80%) and harassment (11.3%). Besides, the SAPRI report also mentions that 55% of the borrowers had to visit the bank for 8-15 times, while 20% required to visit for 16- 30 times as compared to one time in the case of money lenders, Samity and friends in order to get funds. This entire situation, in fact, has increased the cost of funds in doing businesses and created frustration in the minds of the entrepreneurs of the SMEs.

On the supply side barriers, the report (SAPRI) mentions a bundle of factors like the requirement of collateral, equity margin, high transaction costs, shortage of skilled manpower, high risk premium, lack of profitability, lack of standard product, lack of market access and so on that prevent the banks not to disburse credit to the SMEs and start-ups. Finally, financing of SMEs has become very difficult proposition for the bankers' because of the prudential and supervisory regulations adopted by Financial Sector Reforms Project (FSRP) in 1990, which have impacted all categories of borrowers. In fact, the banking system at present requires receiving detailed financial statements from the borrowers including projected cash-flow statements, solvency and liquidity ratios, equity declarations and income tax declarations, which have hindered easy access to credit by SMEs in general.



Beside these problems on the supply and demand sides, it would be worthwhile to note that most SMEs in Bangladesh are family owned and they lack knowledge of strategic planning, and marketing, have no commitment to quality, show little or no knowledge of quality systems, are unable to communicate in foreign languages, and have no experience in cash-flow management or application of information technologies to business – factors which are considered essential to survive in an internationally competitive market environment (SAPRI, 1999). It is important to note that Bangladesh has been following the system of an open market economy since the 1990s and in a liberalized developing economy like Bangladesh, SMEs are exposed to tougher competitive conditions both from domestic and international markets and might end in premature termination of their operations, if adequate financial and non-financial support is not provided to them timely.

#### **4.2.2 Problems and Constraints of the Banking Sector - (NCBs and SBs):**

In the banking sector of Bangladesh the four NCBs and the five SBs mainly cater to the credit needs of the SMEs of the country. Again, these NCBs and SBs alone account for 45.8% of total deposits, 49.3% of total industrial assets and 73.81% of total bank branches and thus dominate the banking system (Annual Report 2005-06, Bangladesh Bank). The four NCBs also supply finance to the state owned enterprises, although most of the state owned enterprises do not show profitability. Therefore, it is the prime responsibility of NCBs and SBs to ensure stability and robustness of the financial system by selecting appropriate borrowers who are not characterized by uncertainties.

But reality is that both nationalized commercial banks and SBs are submerged in high amounts of non-performing loans (table A & B) and low profitability (table C) and they can no longer take the risks involved in the financing of SMEs. An investigative look at the NPL situation of NCBs and SBs from 1990 to 2005 unearths that while in 1990 NCBs accounted for 27.59% of their total loans as NPLs, the same increased to 45.62% in 1999 and then reduced to 21.35% in 2005 (table A). In case of SBs, the NPL is still seen to be at 34.87% (2005), which was 42.8% in the preceding year (table A). Besides, NCBs and SBs are found to be the highest NPLs holders in case of term loans disbursed up to five years, which is 33.83% and 40.45% respectively (table

B). The profitability of the NCBs and SBs is also seen as stagnant. For instance, return on assets (ROA) of both NCBs and SBs is found to be at  $-0.1\%$  in 2005, which was also negative in the year 2004 (table C). Also, NCBs maintained negative ( $-0.4\%$ ) capital adequacy ratio (CAR) as opposed to  $9\%$  in the year 2005.

**Table A: Trend of non-performing loans as a percentage of total loans for different clusters of banks (1990-2005)**

Year	NCBs	PCBs	FCBs	SBs
1990	27.59	23.7	20.65	NA
1991	26.30	34.20	11.87	NA
1992	31.86	31.10	12.64	NA
1993	32.23	44.42	10.46	NA
1994	32.12	44.53	8.89	NA
1995	31.00	39.43	5.40	NA
1996	32.55	34.77	4.72	NA
1997	36.57	31.42	3.58	65.72
1998	40.38	32.72	4.14	66.70
1999	45.62	27.09	3.80	65.02
2000	38.56	22.01	3.38	62.56
2002	33.73	16.38	2.61	56.19
2003	29.0	12.4	2.7	47.4
2004	25.3	8.5	1.3	42.8
2005	21.35	5.62	1.26	34.87

Source: Banking Regulation & Policy Department, Bangladesh Bank, 1995-2005.

**Table B: NPL percentage ratio by type of loans and bank clusters (December 2005)**

Bank types	Continuous loans	Demand loans	Term loans		Micro and agriculture loans
			Up to 5 years	Over 5 years	
NCBs	19.95	10.21	33.83	24.54	47.09
PCBs	6.43	3.83	5.91	5.37	2.03
FCBs	2.31	0.78	0.90	0.49	0
SBs	18.44	5.26	40.45	42.68	39.20
Total	11.06	6.26	13.20	19.56	41.80

Source: Annual report 2004-05, Bangladesh Bank; Financial Sector Review, May 2006, Bangladesh Bank.

**Table C: Trend of profitability for different clusters of banks (1998-2005)**

Bank Types	Return on Assets (ROA) in percentage							
	1998	1999	2000	2001	2002	2003	2004	2005
NCBs	0.0	0.0	0.0	0.1	0.1	0.1	-0.1	-0.1
SBs	-2.8	-1.6	-3.7	-0.7	-0.3	0.0	-0.2	-0.1
PCBs	1.2	0.8	0.8	1.1	0.8	0.7	-1.2	1.1
FCBs	4.7	3.5	2.7	2.8	2.4	2.6	3.2	3.1
Total	0.3	0.2	0.0	0.7	0.5	0.5	0.7	0.6

Source: Annual Report 2003-2004, Bangladesh Bank.

Therefore, the present condition of NCBs and SBs does not allow them to take any additional risks that might increase their NPLs further. Interestingly, the World Bank and IMF also create pressures on the policy makers of Bangladesh to curb the NPLs in order to receive loans and this situation has further influenced bankers' to be conservative in disbursing loans to SMEs. Moreover, policies of prudential and supervisory regulations adopted by the Financial Sector Reforms Project (FSRP) in 1990 have made it mandatory for the banking system to insist on detailed financial statements from borrowers including projected cash-flow statements, solvency and liquidity ratios, equity declarations and income tax declarations for screening of loans. Regrettably, SMEs find it impossible to provide the same and this becomes an obstacle in their way of obtaining finance.

#### **4.2.2.1 Additional Problems – (NCBs and SBs):**

Beside the high amount of NPLs and low percentage of return on assets, nationalized commercial banks and SBs also suffer from some additional problems. For example, they mainly follow government instructions when disbursing credits and supply finance to the state owned enterprises despite knowing inefficiency of this sector. Also, the government instructs nationalized commercial banks to pay salaries of employees and conduct many transactions for other government services such as disbursement of monthly grants given to elderly people, disbursement of salaries and government scholarships, sales of government service application forms and taking of electricity, gas and water bills and so on in exchange for minimal or in most cases, no fees. This consumes significant time, costs and energy on the part of bank officials and adversely impacts the bank's profitability. Further, the promotion system of nationalized banks is mainly based on seniority system, which also de-motivates bank officials to acquire the new and essential knowledge that is required to finance the SMEs. Besides, there is also a lack of training facilities for the bank officials of NCBs and SBs. Moreover, training is considered as punishment rather than reward because training requires tremendous efforts on the part of the officials but bank authorities rarely evaluate their good performance earned by training. Unfortunately, bad performance in training is duly considered while giving promotions. Such factors work behind the reluctance shown by bank officials of NCBs and SBs to take any risks even in areas such as development of skill sets.

#### **4.2.3 Problems and Constraints of the Banking Sector – (PCBs and FCBs):**

In order to provide finance to SMEs, however, one alternative might be to direct the domestic private commercial banks and foreign commercial banks. It is argued earlier in the introduction that they mainly practice branch banking in urban areas and do not feel any compulsion to open branches in rural or semi urban areas because of the presence of high transaction and monitoring costs. Although, at present, domestic private commercial banks book 5.62% (year 2005) of their total loans as non-performing, the same was booked as 12.4% in 2003 (table A). Interestingly, their ROA shows a declining trend, which was 1.2% in 1998, 0.07% in 2003 and –1.2% in the year 2004 (table C). Although, foreign commercial banks are found to be efficient in the management of NPLs (1.26% in 2005) and ROA (3.1%) when compared to PCBs, NCBs and SBs, they usually follow selective credit policies and are not in favor of disbursing loans to SMEs. Unfortunately, banking policies in Bangladesh also do not allow bankers to participate in the equity of the enterprises so that they can actively participate in the businesses of their clients thus reducing the transaction cost of monitoring. In fact, the policy making institutions cannot direct the commercial banks to inject equities as this would create additional risks for the banks and might destroy the confidence of general depositors. Surprisingly, private commercial banks also lacked by skilled human resource to assess credit risks under uncertainties. Foreign commercial banks also behave in the same way as the domestic private commercial banks do, although they have low rates of NPLs. This implies that the entire banking system in Bangladesh faces institutional, financial and human resource problems in taking care of the financing needs of SMEs.

#### **4.2.4 Sectoral Distribution of Advances by the ‘Scheduled Banks’ :**

Sectoral distribution of advances by ‘scheduled banks’ in Bangladesh reveal the importance of small and cottage industries to have decreased over the years. While in 1987 ‘small and cottage industries’ received 3.32% of loans given by scheduled banks, the same decreased to 0.51% in 2005, except in some cases (table D). Even working capital financing to small and cottage industries is seen to be very minimal, only 0.93% of total loans in 2005, and this also shows a downward trend for the last several years. This implies that the banking system of Bangladesh



has reduced the disbursement of loans to small and cottage industries over the years in order to reduce the risks of NPLs. Although, the share of large and medium scale industries has increased to the maximum in 1998 (27.99%), the same has reduced to 15.66% in 2005 and this exhibits the bankers' current behavior of disbursing loans only under secured conditions. In fact, the banking system now does not want to take risks of financing large industries as loan default here is found to be very high (the percentage of NPL in the case of term loan up to 5 years is 33.83% in NCBs and 40.45% in SBs in 2005). Another trend is that the proportion of loans to the agriculture sector has declined over the years (24.94% in 1987 against 8.84% in 2005) and this has also created problems for agro based SMEs in receiving finance. Agro based SMEs occupy a major share of SMEs in Bangladesh. All these factors lead to the conclusion that at present, it has become very difficult for the banking system of Bangladesh to cater to the financing needs of the SMEs.

**Table D: Sectoral Distribution of Advances by scheduled Banks (% of total)**

Sectors	1987	1988	1990	1991	1992	1993	1994	1995	1996	1997	1998
Agriculture	24.94	22.93	21.07	16.62	17.75	16.75	17.32	16.31	15.36	14.09	12.23
Fishing	1.51	1.58	1.62	1.62	1.59	1.51	1.42	1.29	1.08	1.08	1.43
Forestr	0.03	0.03	0.01	0.01	0.01	0.01	0.01	0.03	0.02	00	0.02
Large and Medium scale industry	24.30	19.56	25.39	26.48	25.76	26.22	24.16	26.71	25.72	26.56	27.99
Small scale and cottage industry	3.32	3.49	1.13	1.35	1.47	1.39	1.61	1.51	1.09	1.43	1.53
WC Financing Large and Midium	4.33	4.46	8.69	8.73	8.05	7.91	9.73	8.01	10.30	10.02	9.08

WC Financing												
Small scale and cottage	0.39	0.33	1.03	1.22	1.09	1.55	1.36	1.34	1.43	1.41	1.36	
Construction	3.22	3.33	3.89	4.92	5.12	5.19	5.57	5.40	5.35	5.60	5.36	
Electricity Gas water Sanitary	0.60	0.50	0.18	0.26	0.02	0.09	0.21	0.10	0.20	0.03	0.02	
Transport and communication	2.97	2.50	1.47	1.58	1.51	1.33	1.37	1.56	1.48	1.50	1.41	
Storage	....	.....	.....	0.87	0.83	0.80	0.94	0.89	1.25	1.12	1.47	
Trade	33.70	00	46.25	31.76	32.69	32.18	29.94	29.59	28.94	29.00	28.41	
Export	5.75	00	9.08	4.64	5.31	6.09	6.20	5.81	5.27	5.63	5.98	
Import	00	000	19.67	6.12	6.66	5.61	6.43	6.55	6.21	7.03	6.71	
Miscellaneous	3.40	3.67	1.14	4.60	4.77	4.92	6.37	7.26	7.74	8.17	8.69	

Source: Schedule Bank Statistics', October-December, Different Issues, Bangladesh Bank.

### 4.3 Problems of “NGOs” in Financing the SMEs:

Rural credit markets of developing countries suffer from screening, incentive and enforcement problems which can be better resolved by the ‘group lending’ approach of informal institutions like NGOs and Grameen Bank of Bangladesh and also by mechanisms adopted by informal lenders and vis-à-vis those by formal financial institutions. The idea is that the group lending approach creates moral pressure among the members of the group in the screening of loan applicants and collection of installments spontaneously. Ultimately, it reduces transaction costs, risk premiums and moral hazards of the institutions giving credit. But the formation of these peer groups and their effective supervision are only possible by social development workers who are

working at the rural level and not by formal financial institutions like banks. As a large number of NGOs working in Bangladesh, NGOs would be better in taking care of the needs of SMEs and in fact, the government should encourage them. However, NGOs operate under the Societies Act 1861 that prohibits them to earn profits through business activities. Also, most NGOs receive funds from donor organizations /countries which impose restrictions on them with regard to disbursement of large amounts of credits. Therefore, in practice, it is observed that NGOs basically practice 'income generating activities' and their loan size varies from US\$ 100 to US\$ 3500. They also charge very high effective rate of interest (45% to 120%) as their installment is mostly based on weekly payments. Thus, it is not financially logical for SMEs to loan funds from NGOs that charge very high effective rates of interest as this increases the cost of operations of SMEs and jeopardizes their future growth due to high interest payments in the initial stage. It is to be noted here that loan disbursement record and recovery performance of NGOs are found to be very good but their operating guidelines do not allow them to extend credits to SMEs. In fact, it would not be logical to say that NGOs would cater to the needs of all markets in any economy rather different mechanisms need to be adopted for fulfilling different types of needs.

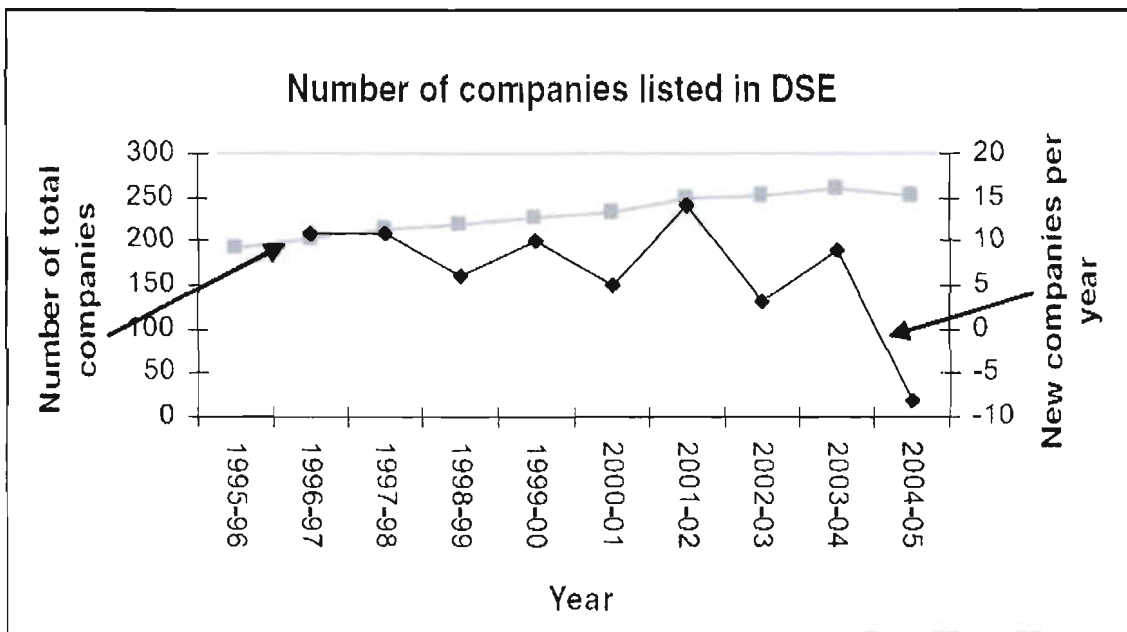
The important point here is that tiny enterprises that receive funds from NGOs and graduate to small and medium size enterprises later, face *financial and non-financial crises* as neither commercial banks nor NGOs fund them. On the whole, it is found that the entrepreneurs of SMEs who require US\$15000 to US\$30000 do not get support from traditional banks and NGOs and is known as the 'missing middle' that needs to be taken care of properly by developing a separate financial mechanism for them to increase the economic benefits of the country.

#### **4.4 Problems of the “Capital Market” in Financing the SMEs:**

The stock market in Bangladesh is not well developed because of several reasons. Firstly, Bangladeshis by nature are usually averse to taking risks (72% of private deposits go to the bank. If we include saving certificates here, the figure becomes more than 90%; Annual Report 2005. Bangladesh Bank) and prefer to invest money in the banking sector rather than in the stock market. Secondly, the majority of the population is uneducated (the literacy rate is 64% as per UNDP report 2004) and people in general have doubts about the credibility of the stock market



especially after the stock market crash in 1997. Thirdly, the country has only two rating houses, and few investment bankers who are yet to earn the trust of the average Bangladeshi household. Most importantly, when raising funds, the stock market requires compliance to certain rules and regulations which the SMEs cannot comply with because of their low base of capital. As a result, it is found that the number of companies that seek capital from the stock market is minimal (not more than ten in a year, except in few cases) and surprisingly, eight companies are seen delisted in their status from the stock market in year 2004-05 (graph 1).



Graph 1: Number of companies listed in Dhaka Stock Exchange and newly listed companies per year.

Source: Constructed by author from Economic Trend, October 2005, Bangladesh Bank.

To sum up, it is found that the banking system of Bangladesh mainly practices collateral based financing and they have huge amounts of nonperforming loans followed by low rates of return on assets. Bank officials also show a marked lack of initiative in increasing their skill sets as promotion system is mainly based on seniority. The banking system does not participate in equities, which is required not only for proper monitoring of SMEs but also to provide non-financial support to them. The banking system also faces constant pressure created by the World Banks and IMF to maintain capital adequacy, which discourages it to finance risky projects. On the other hand, the stock market has not been effective enough to create opportunities for SMEs and finally, NGOs face institutional problems in extending large finance to SMEs.

# **Chapter 5**

## **Analysis and Findings**



## **5. Analysis and Findings:**

### **5.1 Analysis:**

In Bangladesh, several Banks are financing the SME sector but as mentioned earlier, many of them do not have good experience regarding the loan servicing in this sector. Banks lend the projects for making profit, but if the principal amount does not come back to the bank, then there will surely be adverse affect in the balance sheet of the bank. This is because of bank's general function. A Bank's general function is intermediation between borrower and lender. Bank takes deposit from the surplus unit i.e. lender and deploy fund or credit to the deficit unit i.e. borrower. It is very clear that the amount that a bank provides to the deficit units may not be its own. So, it must repay the amount to the depositors on demand. But if the disbursed amount does not come back to the bank, then it may incur loss.

This is the reason why banks are so conscious while lending any project. In recent years, it is observed that there are many defaulters in the SME sector. Many banks are facing this default problem today. Still many banks are willing to invest in this sector.

Though mentioned earlier, from the table – 07, shows that Sonali Bank's credit recovery rate from Small and Cottage Industry sector is only 51.44% compared to the Industrial Credit. The bank has a huge outstanding of credit in the SCI sector.

Actually this is the main reason behind why banks are not interested in financing in SME sector. Banks feel unsecured in financing this sector. Because the credit recovery rate from this sector is not good enough.

#### **5.1.1 Problems for financing SMEs:**

SME sector faces a number of problems to facilitate institutional credit. From the above analysis I have found some point that the borrowers of SME loans are facing some other severe problems that are discussed below: These problems were looked in the perspective of both borrower and lenders.

### **5.1.1.1 Problems from borrowers' perspective:**

#### **5.1.1.1.1 Access to loan:**

SMEs encounter great difficulties while rising fixed and working capital because of the reluctance of banks to provide loans to SMEs. Banks are shy to lend to SMEs because of high processing and monitoring costs of loans to SMEs. The loan application forms for investment financing from banks are long, tedious, and redundant. Since the removal of the interest rate subsidy without the removal of interest band, financial institutions find little incentive to lend to SMEs. SMEs find it difficult to use non real estate assets as collateral to obtain loans from the banks. In the past, the government has attempted to provide SMEs with access to finance through targeted lending. There was a government directive that 5 per cent of a bank's loan portfolio be set aside for small and cottage industry financing. A new bank, namely, the Bank of Small Industries and Commerce Bangladesh Ltd (BASIC) was set up in 1988 with the objective of financing the small and cottage industries. There were also attempts to channelize fund received from international agencies such as the Asian Development Bank (ADB) to the sector through private banks. There were provisions of favorable debt equity ratio, special interest rates and credit guarantee scheme. The central bank also issued directives to both public and private commercial banks regarding working capital loans, use of standardized documentation procedure and time limits for credit sanctioning and loan disbursement.

#### **5.1.1.1.2 Collateral:**

The main problem of SMEs is that, they do not have enough collateral for getting fund from the bank. The banks have some regulation of taking a minimum amount of collateral against credit, but many small and medium entrepreneurs cannot fulfill the requirement. That's why banks are also reluctant to provide credit to them, as it would be violation of their policy regulation.

#### **5.1.1.1.3 Lack of experience:**

Small and Medium Industry Entrepreneurs, in Bangladesh, have lack of experience in the business field. They do not have any training programs and they do not even have any business

exposure. As a result, they cannot follow the right way of entrepreneurship in the related field. So they incur loss in many cases.

#### **5.1.1.1.4 Complexity increases cost of loan:**

Another problem is that extremely high interest rate for the entrepreneurs. Many entrepreneurs is having problem because of high interest rate. Banks, in many cases, maintain high spread as a result there remains reckless competition of making more profit from the Banks perspective. And, sufferers are general entrepreneurs who borrow from the Bank.

#### **5.1.1.1.5 Extremely short grace period:**

In our country, grace period of repaying any credit is very low. According to the SME entrepreneurs, almost all the Banks structured the loan in such a way that entrepreneurs have to start the repayment of credit within a very short time after disbursement of credit. This is really a big problem for the entrepreneurs because the entrepreneurs are bound to generate profit instantly to fulfill the Banks requirement. But this is impossible, as a business needs a minimum time to be in a stable position and to generate profit.

#### **5.1.1.1.6 Absence of comprehensive guidelines:**

Another problem is that, there is an absence of comprehensive guidelines in the SME sector. Most of the SMEs do not have any guidelines for controlling their business. They do not maintain any deliberate procedure in managing the enterprise; rather they go on with the time-to time changes in the business operation. As a result they cannot generate expected profit from the business and fail to payback credit to the banks. Hence, Banks are reluctant to provide credit to them.

#### **5.1.1.1.7 Longer loan processing time and associate cost of uncertainty:**

Credit in this sector requires longer processing time. Though it is Small and Medium Enterprise Sector, processing time for loan is not short. As a result banks are unwilling to enter in this

sector. Moreover, associate cost of uncertainty is also another issue and banks do not want their funds to be invested in an area where recovery of the fund is uncertain.

#### **5.1.1.1.8 Lack of basic infrastructure, inputs, managerial efficiency and inadequate sanction:**

Most of the SMEs do not have basic infrastructure of their own i.e. there is a lack of planned infrastructure in this sector. Inputs of the production are also not planned and insufficient. Moreover, managerial efficiency is also a big issue in this regard. If there is poor managing efficiency, then the organization will never prosper in associate field. For better performance, good managing efficiency is needed.

And, inadequate sanction of loan should also be stated here. The loan provided to this sector is inadequate. As almost all SMEs do not have enough capital to start the business, they need adequate amount of fund in order to support the unexpected loss initially. But as they do not get that, they cannot absorb the initial loss and eventually fail to payback the bank credit.

#### **5.1.1.2 Problems from lenders perspective:**

In addition, some problems identified as these are from lenders perspective:

##### **5.1.1.2.1 Lack of information on loan application requirement among the SME loan seekers:**

As credit application requires availability adequate information, most of the SMEs do not have adequate information. They do not maintain their financial statement appropriately of the business; even they do not feel the necessity of doing so. That's why Banks are not getting appropriate information regarding their business and themselves as well.

### **5.1.1.2.2 Absences of an appropriate and clear-cut legal framework for enforcing quick recovery:**

Even Banks do not have appropriate legal framework in order to recover their disbursed credit. Their recovery framework is not clear-cut as a result they fail to control the servicing of loan.

In addition, the following problems are identified in the SME sector:

- Inadequate allocation of fund for public sector.
- Lack of co-ordination among lending agencies.
- Shortage of long-term credit.
- Unstable share market.
- Lack of technological information.
- Lack of uniform delivery model and training.
- Absences of utilization of BSCIC services of NCBs for utilization of surplus fund.
- Lack of technology assessment, innovation and adaptation of technology.
- Lack of marketing effort and exploring new markets.
- Competitive product market because of market economy.

These are the reasons why Banks are reluctant to finance the SMEs in Bangladesh.

## **5.2 Findings:**

SMEs undoubtedly play a very important role in the economy of Bangladesh in terms of output, employment, and private sector activities. In recent years, structural changes suggest a shift from traditional to relatively modern product categories with higher capitalization and use of better production techniques. But implementing SMEs have faced not only financial constraints as well as it faced some legal, regulatory, and administrative constraints also. These are:

As mentioned earlier, policy reforms of the past decade have brought about substantial relaxation in the investment sanctioning procedure. No prior approval is now required for investments



involving own finance. However, there is scope for further improvement in the following procedural aspects relating to investment regulations:

### **5.2.1 Legal, regulatory and administrative constraints:**

#### **5.2.1.1 Trade License:**

Investors are required to procure trade license from local government bodies by paying statutory fees. The process involves unnecessary delays, harassment and side payments. The procedure needs to be simplified and the issuance of the license made automatic subject to payment of requisite fees and declaration by the investor that the proposed investment is in conformity with the rules and regulations and zoning restrictions of the local government authority.

#### **5.2.1.2 Registration under Factories Act:**

According to the Factories Act 1965, all manufacturing units employing 10 or more workers are required to be registered with the office of the Chief Inspector of Factories and Establishments. The job of the Factory Inspector is to oversee the working condition and safety measures in the factory. In practice, the regulation has proved to be a major source of delay, harassment and unofficial payments for the investors particularly for those in the SME sub-sector as the existing regulations do not differentiate between different size categories with respect to safety and working conditions requirements. To relieve the investors of these problems the requirements relating to safety and working conditions should be defined separately and realistically for the SMEs and the discretionary powers of the Inspector should be minimized. Registration should be automatic once the investor has declared that the requirements have been complied with.

#### **5.2.1.3 Clearance from the Department of Environment:**

All industries are also required to obtain a certificate from the Department of Environment in respect of proper arrangement for anti-pollution and safety measures. Here again, the requirements should be clearly stated for the type and size categories of industry and the investor should be allowed to go ahead with investment on the basis of the undertaking that the requirements will be complied with.

#### **5.2.1.4 Registration with Sponsoring Agency:**

Registration with sponsoring agencies such as the Bangladesh Small and Cottage Industries Corporation (BSCIC), Board of Investment (BOI) or Bangladesh Export Processing Zone Authority (BEPZA) is voluntary unless an enterprise wants to avail itself of government incentives. To keep track of private investment in various sub-sectors, it would be useful to make registration with the sponsoring agency mandatory. However, to relieve the investors of possible hassles, registration procedure should be simplified requiring minimum information to be provided by the investor, and registration should not be held up until the proof of investment has been produced, as the current practice appears to be.

#### **5.2.1.5 Contract Enforcement and Resolution:**

This is a constraint, which is faced by both large and small firms. Inadequacy in the system for contract enforcement and resolution arises from archaic legal system where procedure of adjudication is long drawn out and cumbersome and the system is corrupt. As a result it is not difficult to delay a scheduled date for hearing. SMEs with low sustaining power often lose out in the long drawn out court battle.

### **5.2.2 Minimum requirements for SME financing according to Bangladesh Bank:**

Apart from the specific regulations given under each mode of financing separately, the banks while undertaking Small Enterprise financing should also follow general requirements laid down here. It may be noted that these are the minimum requirements and should not in any way be construed to restrict the role of the management processes through establishing comprehensive credit risk management systems appropriate to their type, scope, sophistication and scale of operations. The Board of Directors of the banks are required to establish policies, procedures and practices to define risks, stipulate responsibilities, specify security requirements, design internal controls and then ensure strict compliance with them.

### **5.2.2.1 Pre-Operation:**

Before embarking upon or undertaking Small Enterprise financing, the banks shall implement/follow the guidelines given below. The banks already involved in Small Enterprise financing will ensure compliance with these guidelines within six month of the date of issuance of Small Enterprise Financing Prudential Regulations.

Banks shall establish separate Risk Management capacity for the purpose of Small Enterprise financing, which will be suitably staffed by personnel having sufficient expertise and experience in the field of consumer finance/business.

The banks shall prepare comprehensive Small Enterprise credit policy duly approved by the Board of Directors, which interlay cover shall loan administration, including documentation, disbursement and appropriate monitoring mechanism. The policy shall explicitly specify the functions, responsibilities and various staff positions, powers/authority relating to approval/sanction of consumer finance facility.

For every type of Small Enterprise finance activity, the bank shall develop a specific Product Program Guide (PPG). The program shall include the objective/quantitative parameters for the eligibility of the borrower and determining the maximum permissible limit per borrower. The PPG will also indicate the maximum permissible exposure banks will take against each product.

Bank shall put in place and efficient computer based MIS for the purpose of Small Enterprise finance, which should be able to effectively cater to the needs of Small Enterprise financing portfolio and should be flexible enough to generate necessary information reports used by the management for effective monitoring of the bank's exposure in the area. The MIS is expected to generate the following periodical reports:

Reports interrelating delinquencies with various type of customers of various attributes of the customers to enable the management to take important policy decisions and make appropriate modifications in the lending program.



Quarterly product wise profit and loss account duly adjusted with the provision on account of classified accounts. These profit and loss statements should be placed before the Board of Director in the immediate next Board Meeting. The branches of foreign banks in order to comply with these conditions shall place the reports before a committee comprising of Chief Executive Officer, Chief Finance Officer and Head of Small Enterprise.

The banks shall develop comprehensive recovery procedures for the delinquent loans. The recovery procedures may vary from product to product. However, distinct and objective triggers should be prescribed for taking pre-planned enforcement/recovery measures.

The institutions starting consumer financing are encouraged to impart sufficient training on an ongoing basis to their capability regarding the various aspects of Small Enterprise financing. The banks shall prepare standardized set of borrowing and recourse documents (duly cleared by their legal counsels) for each type of Small Enterprise financing.

#### **5.2.2.2 Operations:**

Small Enterprise financing, like other credit facilities, must be subject to the Bank's risk management process setup for this particular business. The process may include, identifying source of repayment and assessing customer ability to repay his/her past dealings with the bank, the net worth and information obtained from a Credit Information Bureau approved by Bangladesh Bank.

At the time of granting facility under various modes of Small Enterprise financing, banks shall obtain a written declaration from the borrower divulging details of various facilities already obtained from other institutions. The banks should carefully study the details given in the statement and allow fresh finance/limit only after ensuring that the total exposure in relation to the repayment capacity of the customer does not exceed the reasonable limits as laid down in the approved policies of the banks. The declaration will also help banks to avoid exposure against an enterprise having multiple facilities from different institutions.

Internal audit and control function of the bank, apart from other things, should be designed and strengthened so that it can efficiently undertake an objective review of the Small Enterprise

finance portfolio from time to time to assess various risks and possible weaknesses. The internal audit should also assess the adequacy of the internal control and ensure that the required policies and standards are developed and practiced. Internal audit should also comment on the steps taken by the management to rectify the weaknesses pointed out by them in their previous reports for reducing the level of risk.

The banks shall ensure that their accounting and computer systems are well equipped to avoid charging of mark-up. For this purpose it should be ensured that the mark-up charged on the outstanding amount is kept separate from the principal.

The banks shall ensure that any repayment made by the borrower is accounted for before applying mark-up on the outstanding amount.

#### **5.2.2.3 Disclosure/Ethics:**

The banks must clearly disclose all the important terms & conditions. Fees, charges and penalties, which are internal including interest rate, pre-payment penalties and the conditions under which that apply. For ease of reference and guidance of their customers, banks are encouraged to publish brochures regarding frequently asked questions.

# Chapter 6

## Recommendations and Conclusion

## **6.1 Recommendations:**

### **6.1.1 Seed Money, Leasing, Venture Capital and Investment Funding:**

There is a need for improving different aspects of financial services of SMEs, such as seed money, leasing, venture capital and investment funding. There is a lack of long-term loans; interest rates are high, Guarantee/Security issues, exchange risks etc. All these limit the development of SMEs. Finance, both short and long term, should be provided at market cost of capital. Fund should be made available through encouragement for setting up 'Venture Capital' organization in Bangladesh. The concept of venture capital (VC) has successfully operating in the USA, EU countries, and Canada.

### **6.1.2 Establishment of Small Business Investment and Lending Corporation (SBILC):**

We should start with 'something effective' for industrial development in general and the SMEs sector in particular. Such a step, for example, could be the establishment of a separate corporate body. That means a separate financing institution could be developed, with joint ownership of the public and private sector. To make the proposed initiative effective in achieving its goals, government may set up a Small Business Investment and Lending Corporation (SBILC). The SBILC can be formed under Small Business Investment and Lending Act passed through the Parliament. Under SBILC there may have external and Internal Financing policies. Taken from the different countries experiences the different types of financing policies and programme that can be introduced through SBILC, is enumerated below:

Low Doc Loan Programme, which may allows small business to use a simple on page application for loans up to Tk.50, 000; loans between Tk.50, 000 and Tk.1, 00,000 may require the one-page application plus personal tax returns for three years and a personal financial statement from entrepreneur.

- Direct loans, this type of loan may be provided directly to the small business with public funds and no participation. The interest rate charged on direct loans depends on the cost of money to the government and it changes as general interest rates fluctuate. It can be limited to a fixed ceiling.
- Immediate participation loan can be made from a pool of public funds and private loans.

- **Guaranteed loan.** When private lenders extend loans to small businesses, SBILC in those cases can provide guarantee for repayment in case the borrower defaults on the loan, which may be given for a defined amount of loan and up to certain percentage e.g., 80% or 75% of loans.
- **Seasonal line of credit programme,** may be offered for short-term capital to growing companies needing to finance seasonal buildups of inventory or accounts receivable. The maturity period cannot be exceeding 12 months and the company must repay it from cash flow. Accounts receivables and inventory can be collateral for the loan.
- **Contract loan programme,** is another short-term loan guarantee, but it is assigned to finance the cost of labour and materials needed to perform a contract. Maturity times are up to 18 months.
- **Export working capital programme.** Under this programme the SBILC may give guarantee 90 percent of bank credit line up to a certain limit. In such case Loan proceeds must be used to finance small business exports.
- **Disaster Loans.** As their name implies, disaster loans can be provided to small businesses devastated by some kind of financial or physical losses (such as tremendous flood, earthquakes). Disaster loan may carry below-market interest rates.
- **Greenline revolving line of credit programme.** Greenline programme can be designed to increase small companies' access to working capital by providing them with revolving lines of credit. It can be different than traditional loans, which may require fixed monthly payments; the Greenline programme may employ highly flexible revolving loans, in which cash-hungry small businesses able to draw on a credit line only when they need the money. This loan programme can be designed to provide short-term credit to allow small businesses to finance the sale of their products and services until they can collect payment for them.

### **6.1.3 Periodical Professional Training Courses for SMEs & for Entrepreneurship Development:**

Periodical professional training courses should be arranged for technical staff of SMEs. Moreover training in management of small enterprises and efficient marketing can also be provided. Islamic Chamber regularly organizes training workshops on management, marketing,



procurement of technologies, quality control system and financing of SMEs, for the benefit of representatives of private enterprises and staff of member chambers in different regions of the Islamic World. Training programme / workshop should be organized for the development of SMEs capabilities to acquire enhanced knowledge and skills about how to choose, use and improve technology. At present, no such institution exists except a project of the BSCIC called 'SCITI (Small and Cottage Industries Training Institute). Training on different aspects of SMEs activities for entrepreneurs is crucial for the development of an entrepreneurial.

#### **6.1.4 Establishment of R&D Institute for Enterprise and Entrepreneurship Development, Training and Research Institute:**

In our country Bangladesh, where entrepreneurial initiative is rare and shy, a separate institute for enterprise and entrepreneurship development, training and research should be developed. To make it a 'centre of excellence' in SMEs development, it should be designed, involving educational institutions, business associations, relevant government bodies, private research agencies, and individual consultants having experience in SMEs development.

#### **6.1.5 Establishment of a separate bank for women entrepreneurs:**

Establishment of a separate bank for women entrepreneurs will accelerate the development of women SME through their increased access to formal financial institutions.

#### **6.1.6 Minimum quota for women entrepreneurs:**

Maintaining a minimum quota for loan disbursement to women entrepreneurs and proactively seek out female clients.

#### **6.1.7 Training program for women entrepreneurs:**

Increase the capacity of women entrepreneurs through training and awareness raising activities on financial management, business procedures and other regulatory process such as trade license, tax and VAT, etc. At the same time, initiatives should be undertaken to sensitize the people working with respective regulatory institutions so that women SME can easily arrange necessary documents for loan application and other procedures.

### **6.1.8 Implementation and Monitoring of Policy Measures for SMEs:**

Only policy prescription is not the end, if it is not implemented through different measures timely and properly. How far policy measures are implemented, along with, what effect - desired or not - such policy measures has had on the development of SMEs should also be monitored from time to time. This monitoring will provide feedback for taking corrective actions, if necessary, to ensure desired effect of the policy adopted.

## 6.2. Conclusion:

A vibrant SME sector is considered as one of the principal driving forces in the development of a market economy. They stimulate private ownership and entrepreneurial skills, and are flexible and can adapt quickly to changing market demand and supply situations, generate employment, help diversify economic activity, and make a significant contribution to exports and trade. Even in the developed market economies SMEs account for a large share in output and employment.

There are many constraints in developing the SME sector in Bangladesh. Several studies have identified different constraints, ranging from access to credit to marketing their products and services. However, access to credit is considered as the main constraint. Commercial banks are found reluctant to extend credit to the SME sector. The main reasons are high risk and monitoring cost. To meet the challenge and reduce the perceived risk in lending to SME sector, the Bangladesh Bank has embarked on a program to expand and redesign the existing refinance window of Bangladesh Bank into Small Enterprise Fund (SEF). However, it was thought that the introduction of “Credit Guarantee/Insurance Scheme” or adequate “refinancing facilities” by the Bangladesh Bank may be of substantial help in increasing the participation of the commercial banks in SME financing. Private Banks cannot be expected to undertake this type of financing as additional costs and high risk involved. On the other hand, NCBs that cater to a variety of sectors, from large industries to SMEs will not also be expected to give special attention that SME financing calls for.

The lending institutions should be encouraged to emphasize on the relationship lending technologies, which is based on “soft” information. The soft information may include the character and reliability of the SME’s owner based on direct contact over time by the institution’s loan officer; the payment and receipt history of the SME gathered from the past provision of loans, deposits, or other services to the SME by the institution; or the future prospects of the SME garnered from past communications with SME’s suppliers, customers, or neighboring businesses.

Monitoring of the banking sector in the aspects of loans and advances disbursement should be streamlined as nobody is following government directives. We need to develop various credit products and services, such as credit lines, risk sharing activities, leasing, credit scoring and expert decisioning, efficient credit bureaus. Banking norms and attitudes towards SME financing should be changed as because small enterprises differ considerably from the traditional clientele and do not conform to the norms detailed in the manual of banking norms and procedures. So, it needs a concerted effort of different financial institutions, such as Bangladesh Bank, BSCIC, NCBs, PCBs, SBs or even insurance companies to make SME financing a success.



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## 6.4 Appendix:

### ANALYSIS OF THE SURVEY

In my survey select 10 sectors from the different small business sectors and make a survey on the 20 small business enterprises. I make a general questionnaire. This questionnaire is attached in the appendix. The selected sectors are:

- Boutique Shops
- Laundry
- Hair Dresser and Beauty Parlors
- Tea Stalls
- Restaurants
- Pharmacies
- General Stores
- Stationeries
- Cyber Café
- Tailors

#### Survey Questions and Results:

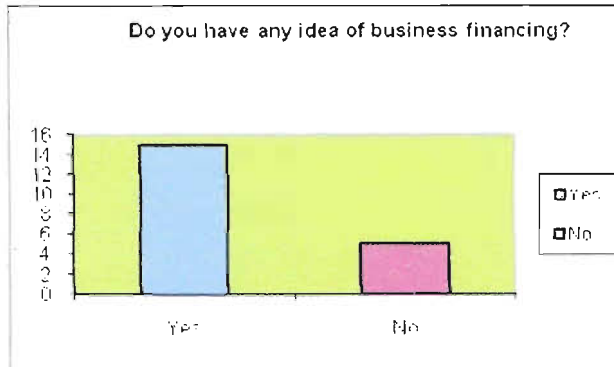
- **Do you have any idea of business financing?**

A. Yes

B. No

#### Do you have any idea of business financing?

		Frequency	Percent
A	Yes	15	75.0
B	No	5	25.0
	<b>Total</b>	<b>20</b>	<b>100.0</b>

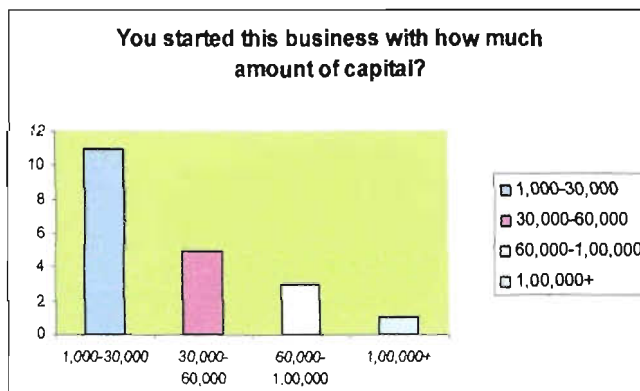


• **You started this business with how much amount of capital?**

- A. 1,000-30,000      B. 30,000-60,000      C. 60,000-1,00,000      D. More than one lac.

**You started this business with how much amount of capital?**

	Frequency	Percent
A      1,000-30,000	2	10.0
B      30,000-60,000	6	30.0
C      60,000-1,00,000	4	20.0
D      1,00,000+	8	40.0
<b>Total</b>	<b>20</b>	<b>100.0</b>

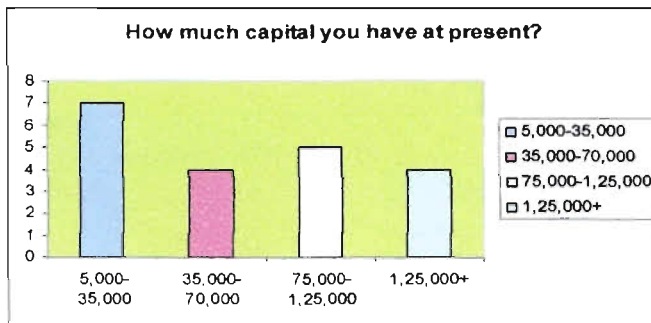


- **How much capital you have at present?**

- A. 5,000-35,000      B. 35,000-70,000      C. 75,000-1,25,000      D. More than 1,25,000.

**How much capital you have at present?**

		Frequency	Percent
A	5,000-35,000	2	10.0
B	35,000-70,000	6	30.0
C	75,000-1,25,000	4	20.0
D	1,25,000+	8	40.0
	<b>Total</b>	<b>20</b>	<b>100.0</b>



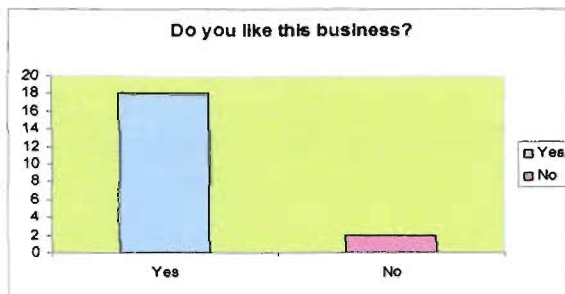
- **Do you like this business?**

- A. Yes      B. No



### Do you like this business?

		Frequency	Percent
A	Yes	17	85.0
B	No	3	15.0
<b>Total</b>		<b>20</b>	<b>100.0</b>



- How many years you involved with this business?  
A. 0-5      B. 5-10      C. 10-20      D. More than 20

### How many years you involved with this business?

		Frequency	Percent
A	0-5	8	40.0
B	5-10	9	45.0
C	10-20	3	15.0
D	20+		0
<b>Total</b>		<b>20</b>	<b>100.0</b>

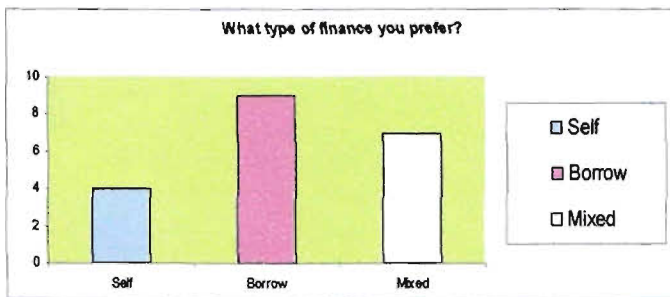


• What type of finance you prefer?

- A. Self      B. Borrow      C. Mixed

What type of finance you prefer?

	Frequency	Percent
A      Self	4	20.0
B      Borrow	9	45.0
C      Mixed	7	35.0
<b>Total</b>	<b>20</b>	<b>100.0</b>



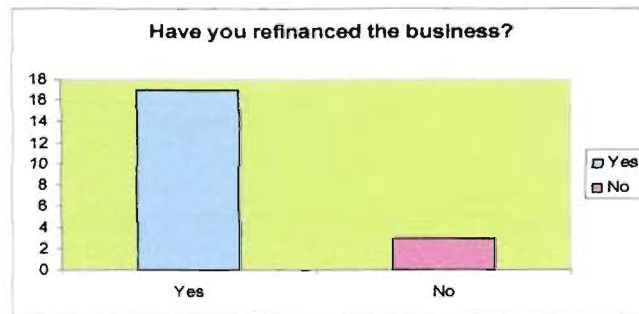
- **Have you refinanced the business?**

A. Yes

B. No.

**Have you refinanced the business?**

		Frequency	Percent
A	Yes	17	85.0
B	No	3	15.0
<b>Total</b>		<b>20</b>	<b>100.0</b>



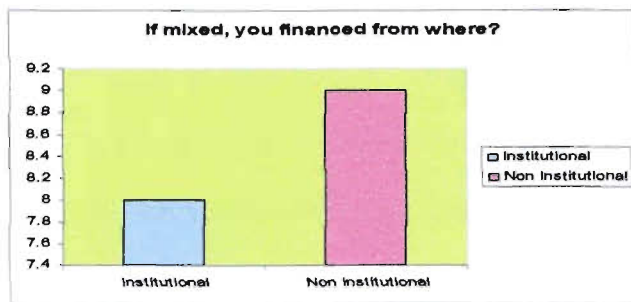
- **If mixed, you financed from where?**

A. Institutional

B. Non institutional

**If mixed, you financed from where?**

		Frequency	Percent
A	Institutional	8	45
B	Non Institutional	9	55
	<b>Total</b>	<b>17</b>	<b>100.0</b>

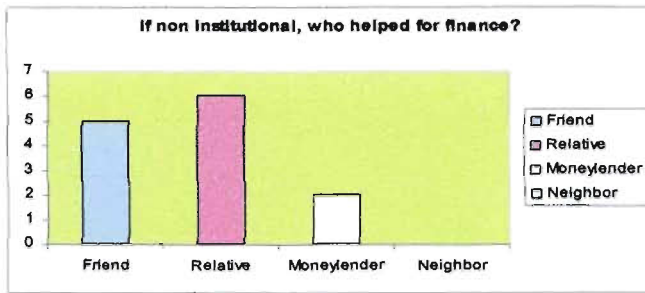


• **If non institutional who helped for finance?**

- A. Friend    B. Relative    C. Moneylender    D. Neighbor

**If non institutional, who helped for finance?**

		Frequency	Percent
A	Friend	5	38
B	Relative	6	46
C	Moneylender	2	16
D	Neighbor	0	0
	<b>Total</b>	<b>13</b>	<b>100.0</b>

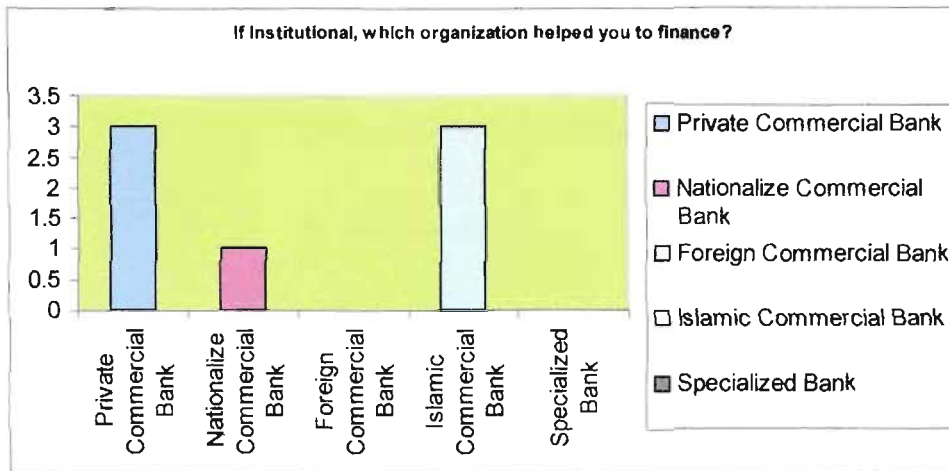


• **If Institutional which organization helped to finance?**

- A. Private Commercial Bank B. Nationalized Commercial Bank
- C. Foreign Commercial Bank D. Islamic commercial Bank.
- E. Specialized Bank F. Non Government Organizations(NGO)

**If Institutional, which organization helped you to finance?**

	Frequency	Percent
A Private Commercial Bank	3	38
B Nationalize Commercial Bank	1	13
C Foreign Commercial Bank	0	0
D Islamic Commercial Bank	3	38
E Specialized Bank	0	0
F Non Government Organizations (NGO)	1	13
<b>Total</b>	<b>8</b>	<b>100.0</b>

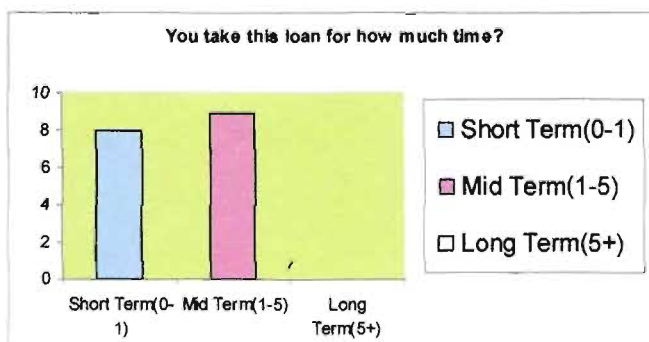


• **You take this loan for how much time?**

- A. Short Term(0-1)    B. Mid Term(1-5)    C. Long Term (more than 5 year).

**You take this loan for how much time?**

	Frequency	Percent
A    Short Term(0-1)	8	47
B    Mid Term(1-5)	9	53
C    Long Term(5+)	0	0
<b>Total</b>	<b>17</b>	<b>100.0</b>

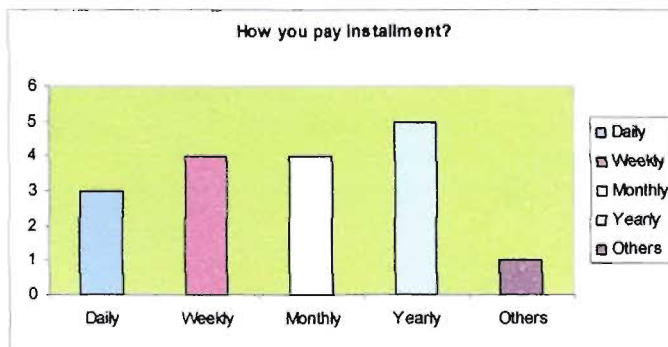


- **How you pay installment?**

A. Daily B. Weekly C. Monthly D. Yearly E. Others

**How you pay installment?**

		Frequency	Percent
A	Daily	3	18
B	Weekly	4	23
C	Monthly	4	23
D	Yearly	5	30
E	Others	1	6
<b>Total</b>		<b>17</b>	<b>100.0</b>



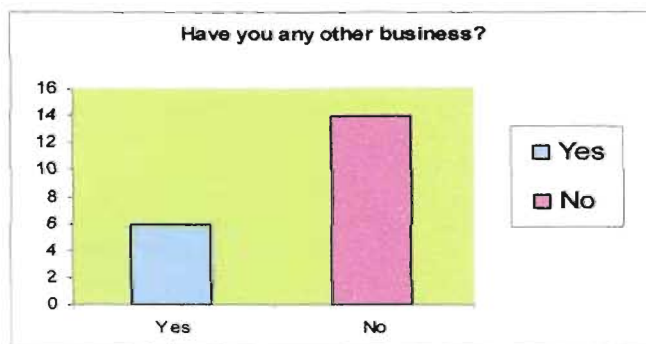
- **Have you any other business?**

A. Yes

B. No

### Have you any other business?

		Frequency	Percent
A	Yes	6	30.0
B	No	14	70.0
<b>Total</b>		<b>20</b>	<b>100.0</b>

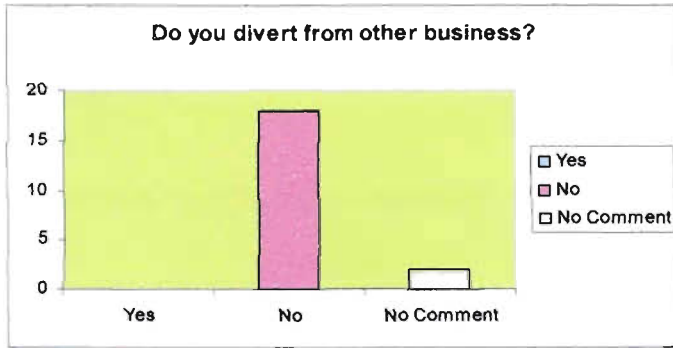


- Do you divert from other business?  
A. Yes      B. No      C. No Comment.

### Do you divert from other business?

		Frequency	Percent
A	Yes	0	0
B	No	18	90
C	No Comment	2	10
<b>Total</b>		<b>20</b>	<b>100.0</b>





- **If yes, from where? Why?**

- Business Owners diverted from other small business because they found it more profitable than previous business.

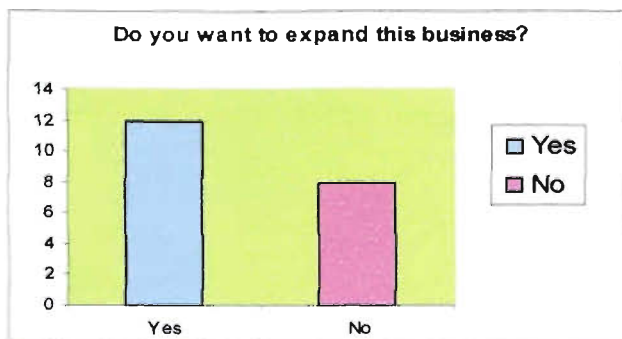
- **Do you want to expand this business?**

A. Yes

B. No

**Do you want to expand this business?**

	Frequency	Percent
A Yes	12	60
B No	8	40
Total	20	100.0



- **If yes, how?**

- Most of the business people who want to expand the business intend to open new branch or enlarge its area of operations.

- **If no, why?**

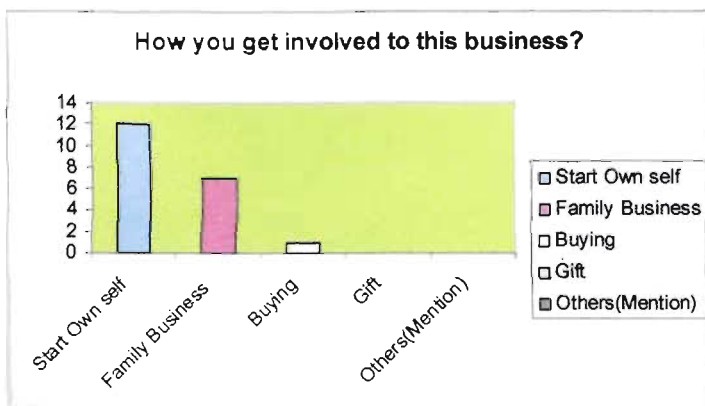
- Business people who think their business cannot providing enough profit don't desire to expand their business.

- **How you get involved to this business?**

- A. Start Own self   B. Family Business   C. Buying   D. Gift  
E. Other (Mention)

**How you get involved to this business?**

	Frequency	Percent
A Start Own self	12	60.0
B Family Business	7	35.0
C Buying	1	5.0
D Gift	0	0
E Others (Mention)	0	.0
<b>Total</b>	<b>20</b>	<b>100.0</b>



- Business owners who got involved to this business are diverted from other business.