

PRESENT STATUS OF SMES AND SME FINANCING IN BANGLADESH: AN OVERVIEW

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Abstract

SMEs are playing very important role for the economic growth and development of Bangladesh. This study has been conducted to assess the present status of SMEs, policies for the development of SMEs and SME financing in Bangladesh on the basis of both secondary and primary data. Some financial tools, techniques and descriptive statistics have been used to analyze the data. The study has found that the growth of SMEs and employment in SME sector are higher than the other sectors in Bangladesh. The growth of credit in industrial sector is higher than that of SME sector. Though the disbursement of credit to SME sector is gradually increasing over the years, the share of industrial credit to SME sector is gradually decreasing over the years. The SME non-performing loan (NPL) to total loan is lower than the gross NPL to total loan. The access to finance is the main constrain faced by 80 percent SMEs in the study area. Again, 91 percent of the study SMEs could not go for the full capacity utilization due to the financing problem. Collateral is the main barrier for SMEs for accessing to the institutional credit. The SMEs have to pay on average 14.44 percent interest on institution credit and 31.22 percent on non-institution credit. The financing gap on an average in each SME is Tk. 10,90,912. Therefore, the government should correct the financial market to ensure the accessibility of SMEs to credit.

Keywords: Small and medium enterprise (SME), Financing, SME Credit, Growth, Employment

Introduction

Small and medium enterprises (SMEs) mean independent businesses which employ less than a given number of employees or whose total investments fall below certain limits. SME means the business with the big opportunity. In spite of global economic crisis and internal economic challenges, the gross domestic product (GDP) of Bangladesh continuously grew more than 6 percent till the fiscal year (FY) 2014-15 and 7.11 percent in the FY2015-16 (Bangladesh Economic Review, 2016). It was ranked fourth amongst the top five fastest-growing emerging economies in 2014 (Asian Development Bank,

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2014). SMEs are playing very important role for the economy of Bangladesh. SMEs are considered as a vital instrument for new employment generation, poverty alleviation and rapid industrialization (Ahmed, 2009). These enterprises are considered as engines of economic growth and the prime mover of any economy around the world. All countries are trying hard to develop entrepreneurs, promote SMEs and facilitating their graduation into large industries for rapid industrialization (Abdin, 2015). Economists, development workers, concerned policy makers and innovators suggest different tools, techniques, methods, and approaches for SME development around the world based on size, capacity and features of the economy. For example, Japanese 'One Village One Product' and Chinese 'One Region One Industry' and Michel Porter's Global Village are widely-known approaches of SME development (Ibid). In the global world, the market is volatile and competitive due to the liberalization of the economy. SMEs accelerate the entrepreneurial skills which help the entrepreneurs to adjust the business with changing market conditions by diversifying economic activities (Helal uz Zaman and Md. Jahirul Islam, 2011). At the same time, the SMEs of Bangladesh are facing many problems. Along with other problems, financing is the major problem faced by most of the SMEs in Bangladesh (Taslim, 2014). If the financing problems had been solved, the SMEs could have contributed more to the economy. Venture capital, bank syndication scheme, HRD in financial institutions and in government offices, training and development etc. as potential tools of eliminating the constrains of SMEs financing (Chowdhury, Azam, and Islam, 2013). The performance of SMEs did not fulfill the expectation of the Bangladesh may be due to the lack of access to institutional financing, lack of consumer base market for SMEs products and non-availability of formal SMEs entrepreneur development initiatives. Therefore, appropriate policies and government initiatives should be taken along with ensuring infrastructural enhancement to face the challenges of SMEs for the further development of this sector (Qamruzzaman, 2015). Medium to long-term credit, limited access to market opportunities, technology and expertise, business information, lack of suitable incentives, inefficient and limited services from relevant government agencies as well as poor capacity of entrepreneurs are other reasons for the slow growth of SMEs (Alam, and Ullah, 2013). The success rate of SME financing is very high as well as it contributes to the GDP in Bangladesh but disbursement of SME loan is lower than industrial loan (Bosri, 2016). Indeed, the implementation of appropriate policies and strategies is a prerequisite to harness sustainable competitiveness of SMEs around the country (Alam, and Ullah, 2006). Therefore, the SME sector should be given priority by providing some facilities and financial services for the development and expansion of this sector. This study has been conducted to draw an overview of SMEs and SME financing in Bangladesh. The specific objectives of this study are: to study the present status of SMEs in Bangladesh; to study the policies for the development of SMEs and SME financing in Bangladesh; and to study the trend of SME financing in Bangladesh.

Materials and Methods

This study is descriptive in nature base on both primary and secondary data. To collect the primary data, the survey method has been used with a structure questionnaire. One hundred entrepreneurs (Respondents) of the SMEs in Rajshahi district have been interviewed under convenient sampling technique from the period of April, 2017 to May, 2017. The secondary data have been collected from government documents of related government offices, journals, websites and the newspares. Some financial tools, techniques and descriptive statistics have been used to analyze the data. In this study, to know the growth rate, the following formula (compound annual growth rate) has been used:

$$\text{The annual growth rate} = \left(\frac{\text{Ending Value}}{\text{Beginning Value}} \right)^{\frac{1}{\text{No.of years}-1}}$$

The formula which has been used to calculate the interest rate is: $i = \frac{I}{PT}$

Where, i = Interest rate, I = Amount paid in interest, P = Principal amount, T = Time period (In year)

When the principal amount of loan with interest is repaid on the installment basis with the same amount at each installment, then it is considered the ordinary annuity. Ordinary annuity means each payment is made at the end of the period. In this case, the 'trial and error' method has been used to calculate the interest rate. The formula which has been used to calculate the interest rate of the annuity under the 'trial and error' method is explained below:

$$i = LR - \left[\frac{PVIFA_{i,n} - F_{LR}}{F_{LR} - F_{HR}} \times (HR - LR) \right]$$

Where, i = Interest rate

LR= Lower interest rate

HR = Higher interest rate

F_{LR} = Factor at lower rate from the financial table

F_{HR} = Factor at a higher rate from the financial table

Again, $PVIFA_{i,n}$ = Present value interest factor of an (ordinary) annuity at a given interest rate (i) and number of the time period (n)

$$\text{So, } PVIFA_{i,n} = \frac{PVA}{PMT}$$

Here, PVA = Present value of annuity (The Borrowing Amount)

PMT = Payment is made at each period

Actually, the authors have used the Microsoft Excel.2010 software to calculate the interest rate.

The lack of funding available from the financial sector for SMEs that could be used productively if the fund was available, but the SMEs cannot obtain this fund from the formal sector is defined as SME financing gap. The financing gap in SME sector has been calculated on the basis of the following way.

Financing Gap = Demand for SME credit - Supply of SME credit

Where,

Demand for SME credit = Amount of institutional credit got by SMEs + Amount of institutional credit required more + Amount of loan from semi-formal sources + Amount of loan from informal sources.

Supply of SME credit = Amount of loan got from the formal sector

Results and Discussion

Bangladesh is an agricultural country, but the contribution of the agricultural sector to GDP and employment is gradually decreasing, and the industrial sector is gradually increasing. Agriculture is no longer the predominant source of income in the Bangladeshi economy. The economy of Bangladesh is transforming from a predominantly agricultural based production structure towards more non-farm based production activities.

Non-farm Enterprises in Bangladesh

The total number of non-farm economic units in the economic census 2001 & 03 was 37,08,152 which has been increased to 78,18,565 in the economic census 2013. It implies that over the two census periods (2001 & 03 to 2013), the economic units have been increased by 110.85 percent (Economic census, 2013). The following table shows the data on establishments by types and location. Based on the definition of National Industrial Policy 2010 the establishments have been classified into five such as cottage, micro, small, medium and large.

The table 1 shows the cottage industries hold the maximum share of the total economic units with an outstanding number 68,42,884 (87.52%) followed by small with 8,59,318 (10.99%), micro with 1,04,007 (1.33%), medium with 7,106 (0.09%) large with 5,250 (0.07%) and SME with 8,66,424 (11.08%). This table also shows that almost all the SMEs (96.09%) are in the service and trade sector where only 3.91 percent are in the manufacturing sector. It is also found that the share of cottage establishments is higher in the rural region than the urban. On the other hand, the share of large establishments is higher in the urban region than the rural. Again, the share of establishments in the SMEs sector is almost same in both rural and urban regions.

Table 1. Total Non-farm Enterprises in Bangladesh

	Cottage	Micro	Small	Medium	Large	Total	SME
No. of Establishments	6842884	104007	859318	7106	5250	7818565	866424
Share of total units	87.52%	1.33%	10.99%	0.09%	0.07%	100.00%	11.08%
Sectorial Composition							
Manufacturing	727233 (10.63%)	104007 (100%)	30890 (3.59%)	2991 (42.09%)	3123 (59.49%)	868244 (11.10%)	33881 (3.91%)
Trades and Service	6115651 (89.37%)	0 (0.00%)	828428 (96.41%)	4115 (57.91%)	2127 (40.51%)	6950321 (88.90%)	832543 (96.09%)
Number of Establishments by Location							
Urban	1730150 (25.28%)	41112 (39.53%)	450601 (52.44%)	4141 (58.27%)	3542 (67.47%)	2229546 (28.52%)	454742 (52.48%)
Rural	5112734 (74.72%)	62895 (60.47%)	408717 (47.56%)	2965 (41.73%)	1708 (32.53%)	5589019 (71.48%)	411682 (47.52%)

Source: Economic Census 2013 and Authors' Calculation (Fig. in the parenthesis indicates the share of total)

Employment in the Non-farm Economic Units in Bangladesh

SMEs are recognized as engines of economic growth and employment generation for sustainable industrialization. The following table shows the distribution of non-farm economic units in terms of employment.

Table 2. Distribution of Non-farm Economic Units in Terms of Employment

	Cottage	Micro	Small	Medium	Large	Total	SME
Total persons engaged (TPE)	13168327	558870	6600685	706112	3466856	24500850	7306797
Share of TPE	53.75%	2.28%	26.94%	2.88%	14.15%	100.00%	29.82%
Sectorial Composition							
Manufacturing	2072309 (15.74%)	558870 (100%)	1165564 (17.66%)	470343 (66.61%)	2916360 (84.12%)	7183446 (29.32%)	1635907 (22.39%)
Trades and Service	11096018 (84.26%)	0 (0.00%)	5435121 (82.34%)	235769 (33.39%)	550496 (15.88%)	17317404 (70.68%)	5670890 (77.61%)
Total Persons Engaged by sex							
Male	11759565 (89.30%)	435043 (77.84%)	5844088 (88.54%)	538526 (76.27%)	1871910 (54%)	20449132 (83.46%)	6382614 (87.35%)
Female	1408762 (10.70%)	123827 (22.16%)	756597 (11.46%)	167586 (23.73%)	1594946 (46%)	4051718 (16.54%)	924183 (12.65%)

Source: Economic Census 2013 and Authors' Calculation (Fig. in the parenthesis indicates the share of total)

The table 2 shows that the total number of 2,45,00,850 persons are engaged in various non-farm economic activities among them 26.94% are in small enterprises, and 2.88%

are in medium enterprises. Therefore, 29.82% of the total persons engaged in non-firm economic activities are engaged in the SME sector. This table also shows that cottage and micro sectors of economic activities secured first and last position in term of total person engagement where 53.75% and 2.28% are engaged respectively. Though, only 14.15 percent of TPE in non-firm economic activities are engaged in the large sector, 46 percent of the TPE in this sector are female. Again, 29.82 percent of TPE in non-firm economic activities are engaged in SME sector, and 12.65 percent of the TPE in this sector are female.

The Growth of SMEs in Bangladesh

The growth has been calculated based on the permanent establishments of the two economic censuses, Economic census 2001 & 03 and 2013. The definition of the type of establishments under the two economic censuses is different. So, comparing the figures between the two economic censuses may not show the actual scenario regarding the growth of the SMEs and the employment in the SME sector in Bangladesh.

Table 3. Growth of SMEs in Bangladesh between Economic Census 2001 & 03 and 2013.

Economic	2013			2003			Annual Growth (%)		
	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural
Total	4514091	1577632	2936459	2991249	1118442	1872807	4.20	3.50	4.60
Cottage + Micro	3731676	1143577	2588099	2911359	1074192	1837167	2.51	0.63	3.49
Small	770063	426376	343687	72935	39127	33808	26.58	26.98	26.10
Medium	7105	4140	2965	3266	2193	1073	8.08	6.56	10.70
SME	777168	430516	346652	76201	41320	34881s	26.14	26.41	25.81
Large	5247	3539	1708	3689	2930	759	3.59	1.91	8.45

Source: Economic Census 2013 and Authors' Calculation

From the table 3, it is found that the annual growth rate of small type of enterprises is the highest (26.58%) followed by medium (8.08%), large (3.59%) and cottage and micro (2.51%). Again, the annual growth rate of the rural sector is higher (4.60%) than the urban (3.50%) where the total growth rate of all type of establishments is 4.20 percent. This table also shows that the annual growth rate of SME sector is higher than the other sectors in Bangladesh.

The table 4 shows that the annual growth rate of employment under small type of industry is the highest (17.22%) followed by medium (12.31%), large (10.18%) and cottage and micro (2.16%). Again, the annual growth rate of employment under the rural sector is higher (8.27%) than the urban (5.57%) where the total growth rate of employment under all type of establishments is 6.99 percent. The growth of SME is higher than the other sectors in Bangladesh. Again, the growth of employment in SME is

higher than the growth of employment in the other sectors in Bangladesh. This sector contributes to develop the rural sector of Bangladesh which may lead to develop the country as the industrialization of Europe or the beginning of a machine industry took place only after a rapid growth and economic change of a principally rural industry (Mendels, 1972).

Table 4. Growth of Employment in SMEs in Bangladesh between Economic Census 2001 & 03 and 2013.

Economic Sectors	2013			2003			Annual Growth (%)		
	Total	Urban	Rural	Total	Urban	Rural	Total	Urban	Rural
Total	19062978	8397411	10665567	9702282	4882924	4819358	6.99	5.57	8.27
Cottage + Micro	8499449	2791285	5708164	6861796	2924217	3937579	2.16	-0.46	3.78
Small	6390577	3001606	3388971	1304935	725378	579557	17.22	15.26	19.32
Medium	706111	337709	368402	221123	150350	70773	12.31	8.43	17.94
SME	7096688	3339315	3757373	1526058	875728	650330	16.61	14.32	19.17
Large	3466841	2266811	1200030	1314428	1082979	231449	10.18	7.67	17.89

Source: Economic Census 2013 and Authors' Calculation

Regulations, Policies, and Organizations for the Development of SMEs in Bangladesh

Ministry of Industries, National SME Task Force, Bangladesh Bank, and Micro Credit Regulatory Authority are the Regulators and Policy makers for the Development of SMEs in Bangladesh. Again, SME Cell, the SME Foundation, the Bangladesh Small and Cottage Industries Corporation, the Bangladesh Industrial Technical Assistance Centre (BITAC), the Bangladesh Council of Scientific and Industrial Research (BCSIR), and the Business Promotion Council (BPC) and other several organizations are involved in SME development in Bangladesh. Ministry of Industries formulates various industrial policies for the development of industries, including the SME sector in Bangladesh. Though the various industrial policies were formulated for industrial development for a specified time, more attention has been given on the SME by the Industrial Policy-2005. Chapter six of National Industrial Policy-2010 was about stimulating micro and cottage, small and medium industries. The policy of "One Village One Product" and creating the advisory center in each district to provide the one-stop service for the SME are taken under the National Industrial Policy-2016 (National Industrial Policy, 2016). "The Policies and Strategies for Development of SMEs 2005," had been formulated by SME Cell of the ministry of industries of Bangladesh. It had given a proposal to form an SME foundation as a central organization for the development of SMEs in Bangladesh. "National Taskforce" for SME Development had been formulated by the government in 2003 for promoting rapid growth of SMEs in Bangladesh to accelerate the growth of the economy and alleviate poverty. SME and Special Programmes Department of Bangladesh Bank

has been formulated a policy of “Small and Medium Enterprises Credit Policies and Programs (2010)” and proposed the target for SME credit, special arrangement for women entrepreneurs and the adoption of cluster development policy by banks and nonbank financial institutions (Website of Bangladesh Bank, 08 May, 2017). SME Foundation has been established as a central institution for SME development in Bangladesh. The vision of this foundation is to promote small and medium enterprises (SMEs), create entrepreneurs and increase the capability of the existing entrepreneurs in the SME sector for alleviating poverty, generating employment and there by accelerating economic growth (Website of SME Foundation, 11 August 2017).

Privileges for Women Entrepreneurs

According to the guideline of the "SME credit policies and programs" of SME and Special Programmes Department of Bangladesh Bank, banks & financial institutions (FIs) will give the highest priority to disburse the SME credit to the women entrepreneurs in SME sector. Again, banks/FIs will have to **give priority** in receiving loan application from women entrepreneurs and make settlement of loan disbursement within a reasonable time. Special advice and service center shall have to be established in selected branches to ensure a service-friendly approach for women entrepreneurs. Women Entrepreneurs' 'Dedicated Desk's hall has to be established in each bank and FIs with providing required and suitable manpower having training on SME financing. A lady officer shall have to be appointed as chief of the dedicated desk. Banks/Financial institutions have to send the branch wise list of Women Entrepreneurs 'Dedicated Desk' to SME and Special Programmes Department of Bangladesh Bank (Bangladesh Bank, 2010). At least, 15 percent of total Bangladesh Bank refinance fund for SME sector has to be allocated for women entrepreneurs. Banks and financial institutions may sanction up to Tk. 25,00,000 to women entrepreneurs against the personal guarantee. In that case, group security/social security may be considered. The interest rate for women entrepreneurs will be Bank rate (which is 5% as of July 2017) plus a maximum 5%; i.e., not more than 10% per annum (Ibid). In the National Industrial Policy 2016, the women entrepreneurs are given priority for access to credit. According to this policy, at least 15 percent of the SME credit will be allocated to the women entrepreneurs. Necessary steps will be taken to increase the minimum limit of the collateral-free loan for the women entrepreneurs (National Industrial Policy, 2016). Women Entrepreneurship Development wing of the SME Foundation is trying to bring the women entrepreneurs to the mainstream of the development process and facilitate them for women empowerment. The main activities of this wing are: institutional capacity building of women chamber/trade bodies, formulate a gender action plan, conduct a study on women entrepreneurs, organize women entrepreneur conference, national SME women entrepreneurship award, SME product fair for women entrepreneur, etc. This wing also tries to encourage bankers to finance the enterprises of women entrepreneurs (Website of SME Foundation, 11 August, 2017).

The trend of SME Financing in Bangladesh

As of May 2017, 56 scheduled banks and 33 non-bank financial institutions (NBFIs) are operating in Bangladesh under the controlled supervision of Bangladesh Bank. Cottage, micro, small, and medium industries are considered as a potential sector for new employment generation through encouraging and expanding the business activities (Bangladesh Economic Review, 2016). Banks and non-bank financial institutions (NBFIs) have taken the initiative for financing the SME sector for the development and expansion of this sector. The following table shows the credit scenario of industrial and SME sectors by the banks and the non-bank financial institutions.

Table 5. Distribution of Industrial Credit and Credit for SME Financing by Banks and Non-bank Financial Institutions (NBFIs)

Years	Total Distribution of Credit (In Crore Tk.)			No. of Entrepreneurs	
	Industrial Credit	SME Credit	SME Credit to Women Enterprises	SMEs	Women-Led SMEs
2012 - 13	145693.87	79346.57	2473.00	642647	36263
2013 - 14	168413.91	90,605.15	3643.11	578018	28983
2014 - 15	215530.42	109473.00	3879.00	699957	193309
2015 - 16	264887.90	125041.00	5427.00	603833	41686
Growth					
2012 - 13	---	---	---	---	---
2013 - 14	15.59%	14.19%	47.32%	-10.06%	-20.08%
2014 - 15	27.98%	20.82%	6.47%	21.10%	566.97%
2015 - 16	22.90%	14.22%	39.91%	-13.73%	-78.44%

Source: Bangladesh Economic Review (Different Years)

From table 5, it is found that the total distribution of credit to the industrial sector and SME sector is gradually increasing over the years. The growth rate of credits to the industrial sector and SME sector has been increased in the FY2014-15 based on the previous years. Again, the growth rate of credits to the industrial sector and SME sector has been decreased in the FY2015-16 based on the previous years. The growth of credit in the industrial sector is higher than the growth of credit in the SME sector. Again, the growth of SME credit to women enterprises is higher than the growth of credit in the industrial sector.

Table 6. Share of Industrial Credit to SME Sector

Years	Share of Industrial Credit to SME Sector (%)		Share of SME Credit to Women-Led Enterprises (%)
	SME Credit	SME Credit to Women-Led Enterprises	
2012 - 13	54.46	1.70	3.12
2013 - 14	53.80	2.16	4.02
2014 - 15	50.79	1.80	3.54
2015 - 16	47.21	2.05	4.34

Source: Bangladesh Economic Review (Different Years) and Authors' Calculation

The table 6 shows that the share of industrial credit to SME sector is gradually decreasing over the years though the share of industrial credit to women-led enterprises of SME sector is sometimes increasing and sometimes decreasing over the years. On the other hand, the share of SME credit to women-led enterprises is also sometimes increasing and sometimes decreasing over the years.

Table 7. Distribution of Credit for SME Financing by Banks and Non-bank Financial Institutions (NBFIs)

Years	Target (crore)	Achievement Against Target (crore)	Achievement Against Target (%)	SME Loans Disbursement by Sector (crore)		
				Trading	Manufacturing	Service
2010	38858.12	53543.93	138%	35040.53 (65.44%)	15147.72 (28.29%)	3355.68 (6.27%)
2011	56940.13	53719.44	95%	34382.64 (64.00%)	15805.95 (29.42%)	3530.85 (6.57%)
2012	59012.78	69753.42	118%	44225.19 (63.40%)	21897.33 (31.39%)	3630.90 (5.21%)
2013	74186.87	85323.25	115%	56703.72 (66.46%)	24016.64 (28.15%)	4602.89 (5.39%)
2014	89030.94	100910.15	113%	62767.18 (62.20%)	30246.20 (29.97%)	7896.77 (7.83%)
2015	104586.49	115870.48	112%	73551.78 (63.48%)	30462.02 (26.29%)	11856.68 (10.23%)
2016	113503.34	141935.39	125%	90547.57 (63.79%)	35168.63 (24.78%)	16219.19 (11.43%)

Source: Bangladesh Economic Review (Different Years) and Authors' Calculation (Fig. in parenthesis shows the share of the credit.)

The lending target to SMEs was introduced by Bangladesh Bank in 2010 for banks and NBFIs. The banks and NBFIs have distributed more than the targeted of SME lending since the year 2010 except the year 2011. The banks and NBFIs have achieved 95 percent of the targeted of SME lending in the year 2011. The table 7 shows that most of the SME lending (more than sixty percent) is going to the trading sector, followed by the manufacturing sector and the service sector. More than fifty percent of total SME loans have been disbursed in the small enterprises, and a major portion (more than seventy percent) of the loans by banks and NBFIs have been distributed in the urban region (Asian Development Bank, 2014). The banking sector in Bangladesh is the largest provider of credit to the SME sector. Bank lending to the SME sector amounted to Tk. 980,330 million that was 97.1 percent of the total SME loans in 2014. The remaining 2.9 percent was made by NBFIs. In 2014, banks expanded their SME credit portfolio by 17.5 percent (Ibid).

Poor quality of the collateral, inadequate documentation, and ill-defined business plans are the main challenges faced by banks for financing SMEs. Guarantee requirements, stringent collateral, and relatively high-interest rates for SME lending might be a critical

barrier for SMEs to access to finance. Banks are reluctant to provide credit for new borrowers, and in most cases, business experience of 2 or more years is needed for SMEs to access bank credit (Ibid). Expanding geographical coverage to serve more clients is the main challenge for NBFIs in serving SMEs. Almost all NBFIs in Bangladesh are urban-centric with limited branches in rural areas. SMEs in urban areas are well served, but the financing gap is more significant in semi-urban and rural areas (Ibid).

Table 8. Non-performing Loans (NPLs) to SME Sector

Item	2010	2011	2012	2013	2014
NPL SME clients to total SME borrowers (%)	3.6	3.6	6.4	7.9	11.8
SME NPLs to total loans (%)	0.8	0.7	1.4	1.9	2.8
Gross NPLs to total loans (%)	7.1	6.2	10.0	8.9	11.6

Source: Asia SME Finance Monitor 2014

Table 8 shows that the non-performing SME clients to the total SME sector are gradually increasing over the years, and it was alarming as it was 11.8 percent in the year 2014. Though, SME NPLs to total loans and gross NPLs of total loans are increasing over the years, but SME NPLs to total loans was only 2.8 percent compared to the 11.6 percent gross NPLs to total loans.

Refinancing Facilities for SMEs

For the expansion and development of cottage, micro, small and medium industries, Bangladesh Bank has been continuing its refinancing facilities during FY2015-16 for banks and NBFIs against their financing to SMEs. Access to finance is inevitable for SME sector development. In many cases, entrepreneurs raise complain regarding the high rate of interest. Indeed, a higher rate of interest is a major hindrance, but the availability of adequate fund is very much important. That is why Bangladesh Bank is committed to facilitating SME credit through refinance window (Bangladesh Bank, 2010).

Table 9 shows that most of the loans under the refinancing scheme of Bangladesh Bank have gone for mid-term financing followed by long-term financing and financing for working capital. Again, most of the commercial/trade enterprises have got a loan under the refinancing scheme of Bangladesh Bank followed by industry and service enterprises. This table also shows that a total number of beneficiary enterprises is gradually increasing over the years. To provide start-up capital to the new cottage, micro, and small enterprises, Bangladesh Bank has created a new fund worth Tk.100 crore from its source. Under this fund the selected prospective entrepreneurs those are trained by recognized public and private training providers have the opportunity to get maximum of Tk. 25 lakh with collateral and Tk.10 lakh without collateral at 10 percent interest rate (bank rate +

5%). As of 30 June 2016, 206 new SMEs have been refinanced the worth of Tk.8.16 crore (Bangladesh Economic Review, 2016).

Table 9. SME Refinancing Facilities

Years	Amount Refinanced (In Crore Taka)				No. of Beneficiary Enterprises			
	Working Capital	Mid Term Loan	Long term Loan	Total Loan	Industrial Loan	Commercial/ Trade Loan	Service	Total
2010-2011	498.93	974.90	456.83	1930.66	6073	12163	2955	21191
2011-2012	620.29	1470.4	544.48	2735.01	10192	18300	4974	33456
2012-2013	704.36	1675.04	740.98	3,120.38	12690	20155	5802	38647
2013-2014	777.71	1,889.83	921.39	3,588.93	14,586	21,547	6,528	42661
2014-2015	1049.08	2246.63	1507.89	4803.6	17476	23321	6913	47710
2015-2016	1355.94	2580.73	1806.52	5743.19	18660	25634	7438	51732

Source: Bangladesh Economic Review (Different years).

SME Financing and Capital Market in Bangladesh

Bangladeshi capital market consists of two (02) stock exchanges. These are the Dhaka Stock Exchange (DSE) and Chittagong Stock Exchange (CSE). The capital market performs the function of issuing primary equity and trading secondary equity. The instruments in these exchanges are equity securities (shares), debentures and corporate bonds. The capital market is regulated by the Bangladesh Securities and Exchange Commission (BSEC). Under the capital market, the Dhaka Stock Exchange (DSE) is the largest stock exchange in Bangladesh. The total number of companies listed on DSE is 331 with having total market capitalization 3847492.863 million as on 08 May 2017 (Website of Dhaka Stock Exchange, 08 May 2017). The Chittagong Stock Exchange (CSE) is another stock exchange, and the number of companies listed on the CSE is 306 as on 08 May 2017(Website of Chittagong Stock Exchange, 08 May 2017). The minimum paid-up capital required for listing on both the DSE and the CSE is Tk. 30 crore, which restricts SMEs from accessing these markets (DSE & CSE, 2015). The DSE also operates an over-the-counter (OTC) market. Currently, only companies delisted from the mainboard can be traded on the OTC market, but the DSE is evaluating the possibility of allowing SMEs to trade on the OTC as the minimum capital requirement for OTC trading is only Tk. 5 crores. The OTC market is regulated by the Bangladesh Securities and Exchange Commission Rules 2001. As of May 2017, 66 companies were trading on the OTC market (Website of Dhaka Stock Exchange, 08 May 2017). According to the definition of Bangladesh Bank, SME refers to the establishment/ firm/business, which is not a public limited company and complies the certain criteria (Bangladesh Bank, 2010). Therefore, SMEs are not eligible to collect the fund from the capital market in Bangladesh.

Financing Problem in SME Sector

Various policies have been taken and implemented by Bangladesh Bank and other institutions to increase the accessibility of SMEs to credit. The following table shows that access to finance is the main constraint faced by 80 percent SMEs of the study population. Among them, 85 percent desired to take a loan from the institutional source/s but did not get any loan. Again, 91 percent of the study SMEs could not go for full capacity utilization due to the financing problem. The main barrier of applying for a bank loan is the collateral demanded by the lenders.

Table 10. Financing Problems in SME Sector

	Access to Institutional Credit	Desire to Take Loan from Institutional Source/s	Suffering from Financing problem	Collateral Requirement Creating Barrier to Get Loan
Yes	20 (20%)	68 (85%)	91 (91%)	58 (71.5%)
No	80 (80%)	12 (15%)	09 (9%)	22 (27.5%)
Total	100 (100%)	80 (100%)	100 (100%)	80 (100%)

Source: Authors' Calculation from the Data of Field Survey (Fig. in parenthesis indicates the percentage of total)

The table 11 implies that the SMEs have to pay on average 14.44 percent interest on institution credit and 31.22 percent on non-institution credit.

Table 11. Average Rate of Interest and SME Financing Gap

Average Interest Rate (%)	
Interest rate on institution credit	14.44
Interest rate on non-institution credit	31.22
SME Financing Gap (in Tk.)	
Total Demand for Credit	1559762.00
Institutional Credit (Supply of Credit)	468850.00
Financing Gap	1090912.00

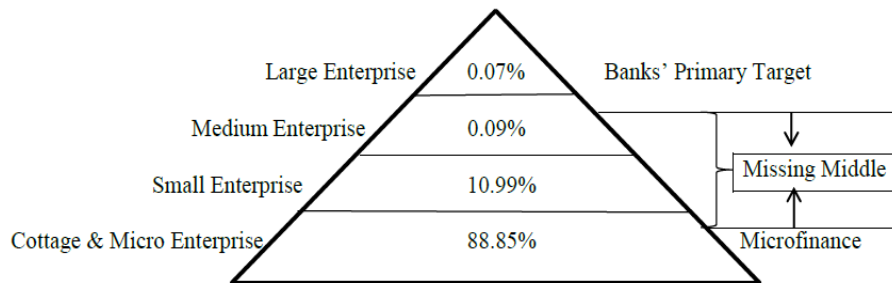
Source: Authors' Calculation from the Data of Field Survey

The financing gap in SME sector has occurred as demand for credit exceeds the supply of credit. The above table shows that the financing gap on average in each SME is Tk. 1090912 of the study population.

Missing Middle

SMEs are the enterprises whose financial requirements are too large for micro finance institutions and too small for bank and financial institutions. Again, the micro and the smallest enterprises are served for financing by micro finance institutions (MFIs), and the

large enterprises are served for financing by banks and NBFIs. SMEs fall in-between these two market segments. This situation of financing in the SME sector is called missing middle, which is represented in the following fig.



Source: Authors' Calculation from Economic Census 2013 and adapted from Badrul and Akhter (2014).

Fig. 1: Underserved Market Segments in Bangladesh (Percentages represent the enterprises)

Missing middle in the financing pyramid means that SME enterprises are neither getting much finance from the MFIs, nor banks and other financial institutions (Badrul and Akhter, 2014). A study shows that due to the lack of experience in record-keeping, poor credit granting practices, over expansion and lack of knowledge of suppliers, 25 percent of start-ups are shut down within the first year of establishment (Hussain, 2014). Generally, most financial institutions do not provide any credit to new borrowers. As a result, a large number of entrepreneurs remain financially underserved. The main challenges faced by financial institutions in servicing SMEs are the inability to provide collateral security, inadequate documentation, and unstructured business planning (Ibid). In some cases, the problem of the SME financing gap may not occur due to the shortage of the supply of fund, but that the demand side cannot define their needs, and do not believe that they have access or could have access to financial services (International Finance Corporation, 2010).

Conclusion

The share of the rural economy is gradually increasing. The involvement of female workers in economic activities is significantly increasing over the years. The share of establishments in the SMEs sector is almost same in both rural and urban regions. The growth of SMEs and the growth of employment in the SME sector are higher than the other sectors in Bangladesh. This sector contributes to developing the rural sector of Bangladesh. The growth of credit in the industrial sector is higher than the growth of credit in of SME sector. Though the disbursement of credit to the SME sector is gradually increasing over the years, the share of industrial credit to the SME sector is gradually decreasing over the years. The SME NPLs to total loans was lower than the gross NPLs

to total loans. Various policies have been taken and implemented by Bangladesh Bank and other institutions to increase the accessibility of SMEs to credit, but the access to finance is the main constraint faced by 80 percent SMEs in the study area. Again, 91 percent of the study SMEs could not go for full capacity utilization due to the financing problem. The main barrier of applying for a bank loan is the collateral demanded by the lenders. The SMEs have to pay on average 14.44 percent interest on institution credit and 31.22 percent on non-institution credit. These interest rates are the nominal interest rates. This study suggests calculating the effective interest rate to know the actual scenario about the interest rate of SME financing. The financing gap on an average in each SME is Tk. 10,90,912 of the study SMEs. SME enterprises are neither getting much finance from the MFIs nor from banks and other financial institutions (FI), which is creating the missing middle problem. SMEs of Bangladesh have no access to the capital market, and the smoothly functioning capital market is missing in Bangladesh. If the financing problem of SME had been solved, the SMEs could have contributed more to the economy of Bangladesh. Therefore, the government should correct the financial market to ensure the accessibility of SMEs to credit.

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Appendix

Definition of Small or Medium Enterprise (SME)

Small or medium enterprise refers to the establishment/firm/business which is not a public limited company and complies the following criteria (Bangladesh Bank, 2016):

Table 1: Definition of SME by Bangladesh Bank

Enterprise	Measurement	Business	Service	Manufacturing
Small Enterprise	On the basis of fixed asset (Tk.)	5 lakh -1 crore	5 lakh -1 crore	50 lakh -10 crore
	On the basis of manpower	6 - 10	10 - 49	25 - 99
Medium Enterprise	On the basis of fixed asset (Tk.)	1 crore-15 crore	1 crore-15 crore	10 crore-30 crore
	On the basis of manpower	11 - 50	50 - 100	100 - 250

Note: If on one criterion, a firm falls into the 'small' category, while it falls into 'medium' category based on the other criterion, the firm will be deemed as in the 'medium' category and vice versa.

Source: Bangladesh Bank