

Strategy for Development of the SME Sector in Bangladesh

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I. Introduction

Accelerating growth and reducing poverty, income inequality and regional disparity are the overarching goals of the current development paradigm in Bangladesh. The main strategy for achieving these goals include creation of productive employment in the manufacturing and organized service sector and withdrawal of labor force out of the low skilled and low return agricultural sector and informal activities.

Development of small and medium enterprises (SMEs) is envisaged as a key element in this development strategy. For achieving double digit growth in manufacturing, matching development of SMEs is considered critical. Enhanced micro, small and medium enterprise activities in the rural and backward regions constitute a key component of the strategy for rural development and reduction of poverty and regional disparity (GOB 2011).

The purpose of the present study is to assess the current situation of SMEs in Bangladesh economy and evaluate the means to integrate the SMEs as a dynamic sector in the economy by overcoming the existing constraints and by articulating proper strategy for facilitating the development of the SME sector in manufacturing to contribute effectively to the objective of growth and equity in the upcoming 7th Five Year Plan

The paper is structured in the following manner. After the introductory remarks in Section I, Section II reviews the status of the overall non-farm sector in Bangladesh based on the Economic Census 2013. Section III discusses current situation of manufacturing SME in Bangladesh based on the Survey of Manufacturing Industry (SMI) 2012. Evidence with respect to growth in SME is presented in Section IV. Productivity variation amongst manufacturing size classes and within SME manufacturing group has been discussed in Section V. Section VI reviews constraints faced by the SMEs while Section VII discusses existing institutional and policy support structure for addressing these constraints. Section VIII makes an assessment of the effectiveness of SME support mechanism, while Section IX examines international experience in SME development. Finally, Section X spells out elements of a strategy for the growth of the manufacturing SME sector in Bangladesh during the 7th Five Year Plan period.

II. Size and Structure of the Nonfarm Sector

Bangladesh Bureau of Statistics (BBS) carried out the third Economic Census of the country during March – May 2013. Like the previous two censuses in 1986 and in 2001 & 2003, the Economic Census 2013 attempted a 100% count of all economic units in the country outside household based agriculture. The full set of data collected through the Census is yet to be processed and published. Preliminary results from the Economic Census 2013 (BBS 2013a) portray the following picture of the economy outside household based agriculture (Table 1).

- The number of nonfarm economic units in the country in 2013 was approximately 7.95 million against 3.71 million and 2.17 million recorded in 2001/03 and 1986 respectively.
- The inter-census yearly compound rate of growth in the number of such economic units rose sharply from 3.4% during 1986 – 2001/03 to 7.2% during 2001/2003 – 2013.
- The number of manufacturing units stood at 869 thousand in 2013 against 490 thousand recorded in the 2001/03 census indicating a yearly compound growth rate of 5.3%
- The share of manufacturing in the overall number of nonfarm economic units declined from 24.5% in 1986 to 13.2% in 2001/03 and further to 10.9% in 2013. This suggests that trade and non-manufacturing service activity, which is the dominant component of nonfarm activities, have been growing at a faster rate (7.4%) than manufacturing activities (5.3%).
- Recent growth in nonfarm activities has been more in rural areas compared to urban areas. During the last inter-census period, number of rural nonfarm economic units increased at a yearly compound growth rate of 8.4% raising its share in the total number of units from 63.9% in 2001/03 to 72.2% in 2013.

Table 1

Number of Nonfarm Economic Units in the Three Economic Censuses

Description	1986	2001/03	2013
Total number of economic units (000)	2169	3708	7950
Inter-census yearly compound growth in total number of economic units (%)	-	3.4	7.2
Number of manufacturing units (000)	531	490	869
Share of manufacturing in total number of units (%)	24.5	13.2	10.9
Inter-census yearly compound growth in the number of manufacturing units (%)	-	Negative	5.3
Number of trade and other service units (000)	1638	3218	7081
Share of trade and other service units in total number of units (%)	75.5	86.8	89.1
Inter-census yearly compound growth in the number of trade and other service units (%)	-	4.0	7.4
Number of rural units (000)	1379	2369	5742
Share of rural in total number of units (%)	63.6	63.9	72.2
Inter-census yearly compound growth in the number of rural units (%)	-	3.4	8.4
Number of urban units (000)	790	1339	2208
Share of urban units in total number of units (%)	36.4	36.1	27.8
Inter-census yearly compound growth in the number of urban units (%)	-	3.4	4.6

Source: BBS (2005), (2013a)

The evidence on size distribution of the nonfarm economic units (Table 2a, 2b & 2c) shows that these are dominated by units with less than 10 workers. Thus, nearly 97% of all nonfarm economic units in 2013 had less than 10 workers. Compared to manufacturing, trade and service activities have a higher incidence of units with less than 10 workers. Similarly, rural units as opposed to urban units have higher incidence of units with less than 10 workers. The size distribution of the nonfarm economic units seems to have changed slightly in favor of the size classes having 10 or more workers during the inter-census period.

Table 2a

Size Distribution of Nonfarm Economic Units in terms of Number of Units 1986

Description	No. of workers				All
	< 10	10 - 49	50 - 99	100+	
Proportion of all units (%)	97.6	2.2	0.1	0.1	100
Proportion of all manufacturing units (%)	96.5	2.9	0.2	0.3	100
Proportion of all trade & service units (%)	98.0	1.9	0.1	0.0	100
Proportion of all urban units (%)	96.5	3.2	0.1	0.1	100
Proportion of all rural units (%)	98.3	1.6	0.1	0.1	100

Source: BBS (2005)

Table 2b

Size Distribution of Nonfarm Economic Units in terms of Number of Units 2001/03

Description	No. of workers				All
	< 10	10 - 49	50 - 99	100+	
Proportion of all units (%)	97.6	2.1	0.1	0.2	100
Proportion of manufacturing units (%)	93.2	5.5	0.5	0.8	100
Proportion of trade & service units (%)	98.3	1.6	0.1	0.3	100
Proportion of urban units (%)	95.8	3.5	0.3	0.4	100
Proportion of rural units (%)	98.6	1.3	0.1	0.0	100

Source: BBS (2005)

Table 2c

Size Distribution of Nonfarm Economic Units in terms of Number of Units 2013

Description	No. of workers				All
	< 10	10 - 49	50 - 99	100+	
Proportion of all units (%)	96.9	2.7	0.1	0.3	100
Proportion of manufacturing units (%)	93.1	5.7	0.4	0.8	100
Proportion of trade & service units (%)	97.4	2.3	0.1	0.2	100
Proportion of urban units (%)	95.1	4.2	0.3	0.4	100
Proportion of rural units (%)	97.6	2.1	0.1	0.2	100

Source: BBS (2013a)

However, the dominance of units with less than 10 workers is somewhat less with respect to employment share (Table 3a, 3b) and this share appears to be declining over time. In 1986, the share of this size category in total non-farm employment was 73.8% that declined to 67.5% in 2001/03. This decline has been more pronounced in the case of manufacturing units. Thus, the share of units with less than 10 workers in manufacturing employment declined from 60.6% in 1986 to 40.4% in 2001/03. Similarly, the size group's share in urban nonfarm employment declined from 61.5% to 51.8% during the same period. Only in the case of rural nonfarm employment, the share of this size group seems to have increased albeit marginally.

The data on employment share of different size categories in Economic Census 2013 is yet to be processed. However, given that the share of units with less than 10 workers declined in the total number of nonfarm economic units in 2013 over 2001/03, this would suggest a decline in the employment share of this size group during this period also.

Table 3a

Size Distribution of Nonfarm Economic Units in terms of Employment Share 1986

Description	No. of workers				All
	< 10	10 - 49	50 - 99	100+	
Proportion of total nonfarm employment (%)	73.8	10.8	2.3	13.1	100
Proportion of manufacturing employment (%)	60.6	9.3	3.3	26.8	100
Proportion of employment in trade & service (%)	83.8	12.0	1.5	2.8	100
Proportion of urban nonfarm employment (%)	61.5	13.5	3.2	21.7	100
Proportion of rural nonfarm employment (%)	83.6	8.7	1.5	6.2	100

Source: BBS (2005)

Table 3b

Size Distribution of Nonfarm Economic Units in terms of Employment Share 2001/03

Description	No. of workers				All
	< 10	10 - 49	50 - 99	100+	
Proportion of total nonfarm employment (%)	67.5	11.4	2.9	18.2	100
Proportion of manufacturing employment (%)	40.4	13.1	4.2	42.3	100
Proportion of employment in trade & service (%)	79.6	10.7	2.3	7.4	100
Proportion of urban nonfarm employment (%)	51.8	13.4	4.0	30.8	100
Proportion of rural nonfarm employment (%)	84.6	9.2	1.6	4.6	100

Source: BBS (2005)

III. Size and Contribution of Manufacturing SME

Over time, the definition of small and medium enterprise (SME) has undergone significant changes in Bangladesh. The evidence presented in this section is based on the following employment cutoff points for various size categories of enterprises provided in the National Industrial Policy 2010.

<u>Size Group</u>	<u>No. of Workers</u>
Micro	10 – 24
Small	25 – 99
Medium	100 – 249
Large	250 or more

According to the latest available Survey of Manufacturing Industry (SMI) carried out by the BBS (BBS 2013b), the manufacturing sector of Bangladesh with 10 or more workers had the following size distribution in 2010-11 (Table 4).

Table 4

Size Distribution of Manufacturing Establishments with 10 or more Workers, 2010-11

Description	Micro (10-24) workers	Small (25-99) workers	Medium (100-249) workers	Large (250 or more) Workers	Total
No. of establishments	17384 (40.6)	15666 (36.6)	6105 (14.3)	3639 (8.5)	42,792 (100)
Total persons engaged	271,644 (5.4)	738,801 (14.7)	1,041,220 (20.8)	2,964,272 (59.1)	5,015,936 (100)
Gross value added (million taka)	92,092 (5.9)	369,974 (23.7)	363,646 (23.3)	737,235 (47.2)	1562,947 (100)
Value added per worker (Thousand taka)	339	501	349	249	312

Source: BBS (2013b)

As is evident from the Table, in 2012, there were about 43 thousand manufacturing enterprises in the country with 10 or more workers, employing a total of nearly 5 million workers. Of these about 41% belonged to micro enterprise category while the shares of small and medium enterprises in the total number of enterprises were 36.6% and 14.3% respectively. In contrast, the shares of these three size groups micro, small and medium enterprises in manufacturing employment with 10 or more workers were 5.4%, 14.7% and 20.8% respectively, and the share in gross value added were 5.9%, 23.7% and 23.3% respectively.

Thus, SME comes out as a significant component of the manufacturing sector (with 10 or more worker) in Bangladesh accounting for 50.9% of the establishments, 35.5% of employment and 47% of gross value added.

Table 5 presents evidence regarding the place of manufacturing SME in the overall manufacturing sector of Bangladesh.

According to the Economic Census 2013 there were nearly 869 thousand manufacturing establishments in the country in 2013, which constituted about 10.9% of all nonfarm economic units recorded in the census. The number of manufacturing units with 10 or more workers was recorded to be 59,748 in the census. In contrast, the SMI 2012 recorded the number of manufacturing establishments with 10 or more workers to be 42,792, which is about 28.4% less than the census figure. Since SMI is basically a sample survey and BBS lacks satisfactory arrangements for updating the manufacturing (10 or more workers) universe, one would suspect the SMI figure to be an underestimate.

Accordingly, a revised estimate of the number of SME manufacturing enterprises (30,406) has been obtained by blowing up the SMI estimate (21,771) by the proportion of the undercount in the total number of manufacturing units with 10 or more workers, which puts the share of SME in the total number of manufacturing units in the country at 3.5%.

The Labor Force Survey (LFS) 2010 (BBS 2011) estimated the size of manufacturing employment to be 6.7 million against the manufacturing employment of 5.2 million recorded in LFS 2005-06. The inter-census yearly compound growth in manufacturing employment thus works out at 5.2%. Using this inter-census growth rate, the size of the manufacturing employment in 2011 has been estimated to be 7.05 million. Similarly, total employment in 2011 has been estimated to be 55.56 million.

The SMI 2012 estimate of employment in manufacturing SME (1.78 million) has also been revised upward in proportion to the undercount in the number of establishments and accordingly the estimate of SME manufacturing employment in 2010-11 stood at 2.5 million, which is 35.5% of the estimated manufacturing employment (7.05 million) and 4.5% of the estimated total employment (55.56 million) in that year.

According to BBS's national income data, manufacturing GDP at current price in 2010-11 stood at 1465.00 billion taka and the share of manufacturing in GDP was 17.75%. The SMI 2012 estimated value addition in SME manufacturing to be 733.62 billion taka and the revised value added figure after adjusting for the undercount stood at 1024.60 billion taka, The share of SME in manufacturing value added thus works out at 69.9%.

Table 5
Place of SME in the Overall Manufacturing Sector

Description	Estimate
No. of manufacturing units in Economic Census 2013	869 thousand
Share of manufacturing in total number of nonfarm economic units	10.9%
No. of manufacturing units with 10 or more workers in Economic Census 2013	59,748
No. of manufacturing units with 10 or more workers in SMI 2012	42,792
No. of SME manufacturing units recorded in SMI 2012	21,771
Revised estimate of the number of SME manufacturing units	30,406
Share of SME in total number of manufacturing units	3.5%
Total persons engaged in manufacturing SME in SMI 2012	1.78 million
Revised estimate of total persons engaged in manufacturing SME	2.5 million
Manufacturing employment recorded in LFS 2010	6.7 million
Share of manufacturing in total employment in LFS 2010	12.4%
Estimate of manufacturing employment in 2010-11	7.05 million
Share of SME in total manufacturing employment in 2010-11	35.5%
Share of SME manufacturing in total employment in 2011	4.5%
Manufacturing GDP at current price 2010-11 (billion taka)	1465.00
Share of manufacturing in GDP 2010-11	17.75%
SMI 2012 estimate of value added by manufacturing SME (billion taka) 2010-11	733.62
Revised estimate of value added by manufacturing SME (billion taka) 2010-11	1024.60
Share of SME in manufacturing value added 2010-11	69.9%
Share of manufacturing SME in GDP 2010-11	12.4%

Source: BBS (2205), (2010), (2011), (2013a), (2013b)

IV. Growth in Manufacturing SME

The size distribution of the manufacturing units in Economic Census 2001/03 and 2013 are shown in Table 6. As is evident from the Table, the employment size group 10-49 workers and the employment size group 50-99 workers experienced higher growth in the number of units than the employment size group <10 workers and the employment size group 100 or more workers during the inter-census period. This suggests that small and medium enterprises covering 10-99

workers size group has been the more dynamic component of the manufacturing sector in Bangladesh during the past decade.

Table 6

Growth in the Number of Manufacturing Units by Employment Size Group

Year	< 10 workers	10-49 workers	50-99 workers	100 or more workers	All manufacturing
2001/03	457081	27114	1672	4927	490794
2013	809271	49080	3447	7221	869019
Yearly compound growth rate (%)	5.3	5.5	6.8	3.5	5.3

Source: BBS (2013a)

The size distribution of manufacturing enterprises with 10 or more workers in SMI 2012 follows the size classification spelled out in the Industrial Policy 2010. However, the size classification used in SMI 2005-06 (BBS 2010) is slightly different. In particular, the SMI 2012 uses the size classes of 100–249 workers and 250 or more workers. But the SMI 2005-06 uses the size classes of 100 – 199 workers, and 200 or more workers. Within the limitations of the variations in size classes, the growth in the number of SME manufacturing establishments and employment during 2005/06 – 2010/11 is seen to be as as below.

Table 7

Size Distribution of Manufacturing Enterprise with 10 or more Workers

Description	No. of workers					Total
	10-19	20-49	50-99	100-199	200 or more	
No. of establishments in 2005-06	15172	11416	2901	1458	3762	34710
Share in total number of establishments (%)	43.7	32.9	8.4	4.2	10.8	100
Total employment in 2005-06 (000)	220	394	216	218	2658	3706
Share in total employment (%)	5.9	10.6	5.9	5.9	71.7	100

Description	No. of workers				Total
	10-24 (Micro)	25-99 (Small)	100-249 (Medium)	250 or more (Large)	
No. of establishments in 2010-11	17384	15666	6105	3639	42,792
Share in total number of establishments	40.6	36.6	14.3	8.5	100
Total employment in 2010-11 (000)	272	739	1041	2964	5016
Share in total employment (%)	5.4	14.7	20.8	59.1	100

Source: BBS (2010), (2013b)

The evidence shows that in 2005-06, manufacturing enterprises with 10-19 workers accounted for 43.7% of the establishments and 5.9% of employment in units with 10 or more workers. But in 2010-11, the share of a somewhat larger group (10-24 workers) came down to 40.6% in the case of number of establishments and 5.4% in the case of employment. Again, the share of manufacturing enterprises with 200 or more workers in 2005-06 stood at 10.8% in the case of total number of establishments and 71.7% in the case of employment. In 2010-11, the share of a slightly smaller group (250 or more workers) stood at lower level of 8.5% in the case of number of establishments and at 59.1% in the case of employment.

This evidence suggests that during 2005/06–2010/11, small and medium enterprises have been the more dynamic component of the manufacturing sector compared to both micro and large enterprises.

V. Productivity in Manufacturing by Size

It was shown in Table 5 that in 2010-11 the share of SME in manufacturing value added (69.9%) was much higher than its share in manufacturing employment (35.5%) implying that SMEs are efficient users of labor. This is also corroborated by the evidence presented in Table 4, which shows that value added per worker is higher in small and medium enterprises compared to both micro and large enterprises.

However, lack of data does not permit assessment of recent trend in manufacturing productivity by size class. Prior to 2012, SMI reports did not provide value added data by size classes. The Economic Census also does not provide any information on value addition. Information on value addition in economic units with less than 10 workers is provided in the BBS's Annual Establishment and Institution Survey (AEIS) Report. But the latest published report of AEIS is for the year 2002-03.

A recent Study (Ahmed et al 2013) examined trend in labor productivity by size class in the manufacturing sector in Bangladesh using AEIS data for 1991/92 and 2002/03 and unit level data from the SMI for the period 1995/96 and 2001/02. The broad findings of the study were as follows.

- Household based manufacturing units with <10 workers experienced decline in both the number of units and employment and had yearly growth of only 0.5% in labor productivity.
- Non-household based manufacturing with <10 workers experienced moderate growth of 2.5% in the number of establishments and 3.7% in employment with yearly productivity growth of only 1.3%.

- There has been significant narrowing of spread between the large enterprises and their small and medium counterparts with respect to value added per worker due to capital deepening in the latter size group of manufacturing enterprise.
- There are significant inter-industry variations in productivity growth in small and medium manufacturing enterprises. While traditional small industries such as grain mill, saw mill, handloom etc. either stagnated or experienced decline in employment, there were the more dynamic components of the SME group, (such as plastic products, footwear, miscellaneous food products, job printing, domestic market oriented garments products, chemical products etc.), who by taking advantage of the liberalized trade regime, upgraded their technology and product quality that contributed to higher level of labor productivity.

Variation in labor productivity within the SME manufacturing enterprises has been corroborated by a survey of six manufacturing industries carried out by the SME Foundation in 2006-07 (SMEF 2006/07). It was shown in the study that capital labor ratio in these six industries varied from a low of Tk. 28 thousand to a high of Tk. 249 thousand in the case of small enterprises (coefficient of variation 73.1%) and from a low of Tk. 30.37 thousand to a high of Tk. 438 thousand in the case of medium enterprises (coefficient of variation 73.5%). The variability in the labor productivity was even higher – co-efficient of variation in the case of small enterprises was 97% against 125% observed in the case of medium enterprises. However, a close association was observed between capital intensity and labor productivity, the coefficient of correlation being 0.71 in the case of small enterprises and 0.75 in the case of medium enterprises.

VI. Constraints faced by SMES

Lack of freehold land

A stumbling difficulty faced by investors in setting up new enterprises is paucity of freehold land. The existing system of maintaining records of land transactions is highly deficient and it becomes extremely difficult to ascertain the legal status of any land. Because of these reasons land purchases often results in prolonged litigation creating serious problems for the investor. Industrial estates set up at public initiative have addressed only a tiny part of this need. In some cases, inappropriate location of these estates has resulted in gross under-utilization of the industrial estate land. Although, there has been a lot of private investment in the housing sector and in setting up of shopping malls and commercial space, industrial estate at the behest of the private sector is yet to emerge and may require strong fiscal incentives and support from the government.

Deficient infrastructure and utility services

Deficient physical infrastructure and utility services constitutes one of the major impediments to SME development in Bangladesh. It is widely acknowledged that greater investment and/or better performance from existing infrastructure facilities and utility services would have high returns in terms of reduced costs of doing business. In an earlier perception survey of sample entrepreneurs (ICG/MIDAS 2003), it was found that the respondents considered electricity to be the most serious structural bottleneck encountered by them. Lack of access to gas and electricity constitute the binding constraint to decentralized growth of private investment, particularly of SMEs. A recent survey of 120 manufacturing SMEs (INSPIRED SME Survey, 2013) revealed that 86.8 percent of the respondents considered electricity to be the main problem. This implies that notwithstanding the recent increase in electricity generation, SMEs still suffer from lack of electricity.

The opening of the power generation activities to the private sector has been a positive development and has facilitated inflow of considerable foreign investment into the sector. But pouring more power into the system is not the only way of coming to grips with problems in this sector. Much more needs to be done with regard to outdated transmission and distribution lines, load management, transmission and distribution losses, and reforms of the pertinent parastatal bodies.

Chittagong port, which is the country's only deep-water port, is technically outdated and inefficiently managed. The handling productivity is below five containers per vessel-hour, and total turnaround time is the longest in the region. The port operations suffer from too many vested interests, including politicized unions that effectively blocked reform efforts. Apart from high monetary costs inflicted by such dysfunctional operation of the port, it has also earned Bangladesh a poor reputation for delivery in the time-sensitive and highly competitive markets for garments, shrimp and other exports. Modernization of both the physical facility and the management of the port thus is an urgent necessity.

Deficient legal and regulatory framework

Major weaknesses in the legal framework are with regard to contract enforcement, dispute settlement, bankruptcy laws, copyright protection, land titling and labor laws. Current legal procedure has loopholes that allow one to adopt delaying tactics and as a result the court faces a big backlog of cases. Bankruptcy law has recently been enacted but its implementation is yet to be tested. With regard to copyright protection Bangladesh is covered by the TRIPS agreement, but local firms lack the knowledge of their rights and obligations. Existing labor laws are inadequate to discourage politicization of labor relations, which has been a major deterrent to investment. Labor laws also need to conform to the emerging labor standard issues. Land titling and transfer procedures have remained very cumbersome and corruption prone. Streamlining of

red tape, improvements in law and order situation and legal environment are essential to assure prospective investor that there is adequate legal protection to legitimate business.

Policy reforms of the past two decade have brought about substantial relaxation of the regulatory environment. Investment sanctioning requirement has long been abolished and registration of enterprises made voluntary. But investors still complain about a lot of regulatory requirements, which they need to fulfill before an enterprise can be set up and most of these apply in an undifferentiated manner to large enterprises and the SMEs. These include, trade license to be obtained from local municipal authorities, environment safety clearance to be obtained from the department of environment, registration with the Inspector of Factories, export registration with the Export Promotion Bureau, import registration with the Controller of Import, VAT registration with the revenue department etc. While the case for enterprise registration for the purpose of safety and public health, environmental concerns, fiscal purposes and monitoring etc. is well taken, in the absence of coordination between different authorities, the entrepreneurs have to obtain these clearances separately from each agency, involving duplication of efforts, time loss, harassment and unofficial payments. There is, thus, the critical need for simplifying and streamlining all these regulatory measures under one unified arrangement. The burden on the SME investor could also be eased somewhat by delegating some of these authorities to the Chamber bodies.

Inadequate access to finance

Among the many compelling reasons why SMEs fail to realize their full potential, inadequate access to finance is prominent and most commonly cited. With limited capital base of their own and little or no access to institutional financing they rely on inefficient financing service traditionally from informal sources, which eventually proves unsustainable let alone stimulate growth. The INSPIRED SME survey reveals that 68.6 percent of small enterprises and 44.7 percent of medium enterprises identified access to finance as a major constraint. High interest rate is mentioned as a hindrance as well. The surveyed SMEs were lent at an interest rate of 15.6 percent in 2012.

In the past, government has attempted to provide small and medium enterprises with access to finance through targeted lending. There was a government directive that 5 per cent of Bank's loan portfolio be set-aside for small and medium enterprise financing. A separate bank, namely, the Bank for Small Industries and Commerce (BASIC) was set up in 1988 with the objective of financing the small and medium enterprises. There were also attempts to channelize to the sector through public and private banks fund received from international agencies. 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.

Notwithstanding all these arrangements for financing small and medium enterprises, the actual delivery of institutional credit to this sector has been grossly inadequate. One of the main factors that have hampered flow of institutional finance into small and medium enterprises is banks' pre-occupation with collateral based lending. Traditionally banks have used fixed asset ownership particularly land ownership as the basis for judging credit-worthiness. This puts small and medium enterprises at relative disadvantage as they often cannot put up such collateral for loan. Moreover, whatever collateral they can manage gets used up in taking the term loan leaving them with no means to seek working capital loan from institutional sources. Unlike their large-scale counterparts they cannot use influence and contacts and solve the problem by putting up collateral of dubious valuation. Banks, on their part, also tend to be less flexible about the collateral requirement in the case of the SMEs as they perceive SME loan to be more risky and the cost of monitoring and supervision of small loans to be higher.

Various alternatives to real estate based lending have been suggested for the SMEs. Group guarantee and peer pressure, successfully used in the case of micro-finance, do not appear appropriate for SMEs as these are mostly sole proprietorship units with capital size significantly larger than the amount typically disbursed under micro-finance. Use of assets other than land and building, such as fixture, equipment, vehicles etc. as collateral is also a fairly standard practice in institutional finance but is of less use in the case of SMEs as these enterprises usually possess few such non-land assets. Sales proceeds, accounts receivable, inventory etc. can be the basis of working capital loan, but this requires proper documentation of the transactions of the SMEs and close monitoring and supervision on the part of the lending institutions. Because of the informal nature of many SME transactions and high cost of small loan administration, use of such movable asset for working capital lending will involve certain difficulties.

The lack of access of SMEs to institutional finance is observed to be even higher when it comes to women owned or women managed enterprises. There is a general trend towards rise in women entrepreneurship in Bangladesh, but women trade bodies claim that social acceptability of this trend is not reflected in the attitude of the lending agencies, which discourages them from seeking institutional finance.

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

Loan processing, particularly in the case of public sector banks, involves high transaction costs for borrowers in terms of time and visits needed and unofficial payments made. Because of lack of proper autonomy and accountability, the public sector financial institutions are beset with inflexibility, inefficiency, political interventions and corruption. Since the performance of the bank officials is not properly evaluated they lack the incentive to bring larger number of suitable borrowers, particularly those in the small and medium enterprise sector, within the fold of institutional financing. They adopt a passive and inflexible attitude towards the borrowers either to avoid the risk of making an inappropriate lending or to force the borrower to make side payments for more favorable handling of the loan application. These problems are unlikely to go away without major institutional reforms of the public sector banks.

Another major weakness of business financing in Bangladesh is lack of its modernization for purposes of e-commerce. In the context of an evolving globalized trading system the importance of e-commerce can hardly be overemphasized. But due to the absence of congenial telecommunication facilities and appropriate financial systems, business enterprises particularly SMEs have not taken any initiative towards e-commerce.

Human resource development

Deficient entrepreneurial, managerial and technical skill is a major supply-side bottleneck in Bangladesh that has constrained growth and diversification of the industrial base in general and the SME and export sector in particular. The INSPIRED SME Survey 2013 found the problem of human resource to vary with the size of the firm. The survey found rising labor costs and lack of skilled production workers as the two major human resource related problems faced by the SMEs. The problem with human resource arises partly due to gross miss-match between the type and quality of skill required by the private sector and the skill that is imparted by the institutions.

There is, thus, the need for significant private sector initiative through the chamber and other trade bodies for planning and implementing trade specific skill development program. The financial involvement of the trade bodies in these programs will ensure both practical relevance and efficient implementation of the program. Matching grants from public and donor sources will help such programs get off the ground and be self-sustainable eventually. The fashion and design institute set up by the Bangladesh Garment Manufacturer's and Exporter's Association (BGMEA) with support from the government and donors is a case in point. Fiscal incentives should also be provided for in-house training provided by individual enterprises. There is also the need for separate program for women entrepreneurship development.

Business support services

Public institutions mandated to provide business support services are usually ill-equipped and ill-staffed and the programs they implement are not found very useful by the business community. Product development, technological improvements, market promotions, and quality controls are the especially deficient areas of business support measures. To remedy the situation, public sector agencies such as BSCIC, Bangladesh Standards and Testing Institution (BSTI) etc. should have close collaboration with the trade bodies. For example, there is the need for trade specific initiative to set up standards as per international requirements. With support from matching grant facilities, the trade bodies can play an important role in this regard and also in helping member enterprises to get internationally recognized certification such as ISO 9000.

The other major area of deficiency is the lack of reliable and up to date information on the sector. There is no single agency with which private investment is recorded. Different agencies maintain different sets of information but these are neither complete nor consistent and there is no coordination amongst these agencies for bringing out a collective picture of the sector. There is urgent need for putting in place a centralized reliable system of business statistics.

Need for supportive trade policy for providing easier access to imported input

Easier access to imported inputs facilitated the growth of SMEs in a number of industries, particularly in the field of plastic, other food, footwear, rubber products, chemicals, job printing and certain categories of metal based products. Since trade restrictions usually put a greater burden on the SMEs vis-à-vis their large-scale counterparts, reforms in trade policy brought about quick supply response from the SMEs.

Plastic industry has not only succeeded in substituting imports but has also been able to penetrate the export market in specific range of products such as drums and bulk containers etc. The industry has also been producing items that are considered deemed export, e.g. accessories for the garments industry etc. Similar export successes have also been achieved by imported metal based engineering product industries. Thus, export of engineering products has experienced significant growth during the last two decades, with production carried out by enterprises belonging to the SME sector. Easy import of components has also facilitated the rapid growth of a wide variety of footwear products in the country. Similarly, lower cost of imported paper and ink has helped commercial job printing to grow rapidly. Import of packaging materials at lower cost has contributed to the growth of other food industry. Rubber products and other chemical products also seem to have benefited from easier access to raw materials due to trade liberalization.

While, trade liberalization made imported inputs available to these industries at lower cost, these industries did not face much displacement from competing imports of finished goods because of two reasons. First, they enjoyed comparative advantage due to the labor intensive nature of some of the products. Second, many of these products catered mainly to the consumption demand of low and medium income people for whom imports despite lowering of tariff remained out of reach.

However, the process of trade liberalization became somewhat protracted during the past decade and imposition of various types of para tariffs raised the cost of imports putting SMEs in disadvantaged situation vis-a-vis their large scale counterparts. In the survey of six sub-sectors carried out by the SME Foundation in 2006-07, high import cost of input was mentioned as the second most important constraints faced.

Fiscal incentives

Fiscal policy in Bangladesh is not particularly tailored to provide support to SMEs and in many cases, it discriminates against them. The system of tax holiday is not available to sole proprietorship enterprises, which is the usual form of SME in Bangladesh.

SME entrepreneurs complain that there is virtually no differentiation between SMEs and their large-scale counterparts with respect to VAT, supplementary duty and excise taxes. Cottage enterprises are exempted from these indirect taxes and there is a cut off annual turnover of Tk. 15 lac below which SMEs pay Turnover tax at a discounted rate. But this cut off limit is rather low and most SMEs are required to pay VAT at the same 15% rate as their large-scale counterparts. Since raw material procurement of many SMEs takes place from informal sources and since the SMEs have difficulties tackling the tax officials, administration of VAT in SMEs in the same manner as large enterprises put them at a relative disadvantage.

VII. Institutional and policy support structure for SMEs

The Government is committed to develop SME as one of the main pillars of economic growth to achieve the goal of becoming a middle income country by 2021. The primary role of the Government has been delineated as that of a facilitator to aid naturally growing SMEs through removing market and policy obstacles, and secondly providing necessary promotional support. The Government constituted a National Taskforce on SME Development in 2003 to draw up a realistic strategy for promoting rapid growth and vigorous competitiveness among SMEs in Bangladesh in the interest of accelerating the growth of the economy and reduction of poverty in the country. The Task Force identified common constraints faced by SMEs in Bangladesh and made a number of recommendations leading to the setting up of a new institution to promote

SME in Bangladesh, namely, the SME Foundation. The idea was that this foundation will serve as the central authority to steer both policies and actions designed to support SMEs.

The SME Foundation was created under the Ministry of Industries as an apex institution for SME development in the country through a gazette in 2007. The major activities of the Foundation include (i) implementation of SME Policy Strategies adopted by the Bangladesh Government, (ii) policy advocacy and intervention for the growth of SMEs, (iii) facilitating financial supports for SMEs, providing skill development and capacity building training, (iv) facilitating adaptation with appropriate technologies and access to ICT, and (v) providing business support services, etc. The Foundation is intended to work as a one-stop service delivery window for SMEs.

With the establishment of the SME foundation, the overall support structure for SME development in Bangladesh became a multi-institution approach. Each of them works in some specific areas although with some overlaps.

i) Ministry of Industry

In formulating the industrial policy of the country, the Ministry of Industry duly emphasized on the development of the SME in country. Chapter 6 of National Industrial Policy- 2010 is about promoting small, medium, micro and cottage industries. This chapter clearly laid out the objectives that the government wanted to accomplish and the policy directions for that. The primary role of the Government shall firstly, be that of a facilitator removing policy obstacles and neutralizing market failures. A SME cell has been instituted within the Ministry with the objective of providing to the SMEs the necessary promotional support of various kinds like the following:

(a) It will accentuate and sustain SME activities through motivation, loan allocation and training of the entrepreneurs.

(b) The ministry will take necessary steps will be taken to provide women entrepreneurs with pre-investment advice and assistance in drawing up and implementing projects. Necessary assistance and services would be provided by SME Foundation and BSCIC. Private sectors will also be involved in the development of SMEs through public-private partnership (PPP) arrangement.

(c) All public sector technical training institutions will be utilized to impart training and related activities for enhancing the efficiency of entrepreneurs leading to increased efficiency and competitiveness of SMEs.

(d) The ministry will work with other ministries like ministry of finance so that SME development strategies shall be embedded in other public policies like the Medium Term Budgetary Framework (MTBF).

(e) The ministry will help implement dispute settlement procedures that proactively shield small enterprises especially from high legal costs and insidious harassment, if any.

(f) The ministry will take innovative measures to create avenues of mobilizing debt without collaterals in order to assist small enterprises in dealing with their pervasive lack of access to finance.

(g).The ministry will take measures to harness information & communications technologies, internet protocol (IP)-based infrastructure, and electronic-governance etc. in an effort to parlay regulatory services, all kinds of useful information and mentoring inputs, with an accent on increasing the viability of SMEs in all sectors of the economy. In this context, it will work with other ministries.

However, despite the identified areas for actions as described above the ministry of industry is yet to make any notable progress. It has received a technical assistance to support the growth of the SMEs. A national SME development strategy and action plan is currently being prepared. However, such a strategy had already been prepared in 2005, which provided the theoretical underpinning of the formation of SME foundation. The foundation has also conducted a number of sector studies to identify the sector-specific actions. Thus there was hardly any need to duplicate the efforts.

ii) BSCIC

Bangladesh Small and Cottage Industries Corporation (BSCIC) is a subsidiary organization under the Ministry of Industry. It was established by an act of the Parliament in 1957. The main responsibilities of this subsidiary include development of industrial estate, imparting entrepreneurship skill development training, promoting sub-contracting, and running credit program.

The Small and Cottage Industries Training Institute (SCITI) was set up in 1985 under BSCIC. This is the only Institute in the country to support the entrepreneurs in SME sector and their employees in the development of their entrepreneurial & managerial skill. This institute is also supposed to impart training for the extension officials of both public and private sector agencies on different aspects of SME development. BSCIC arranges credit facilities under credit programs such as (a) self-employment through small & cottage industries, and (b) United Nations Capital Development Fund (UNCDF)

BCSIC is primarily concerned with the development of industrial estate/park for all kinds of industries with the required infrastructural facilities like water, electricity, gas, road etc. There are 74 such industrial estates developed and managed by BCSIC at present. Their average size is 50-60 acres. Given the size of these industrial estates, they are more suitable for small and medium industries.

Although sole mandate of the BCSIC is to develop small and cottage industries, and for quite a long time it was the only organization to do that, it did not have much success in its record. The industrial estates developed by BCSIC not only suffers from infrastructural deficits but also not ideally located. Most of the activities of the BCSIC, be it industrial estate or training program, are not well-aligned with the need of the naturally developed SMEs. Government is now developing special economic zone (SEZ) to develop industrial plots for all kinds of enterprises. With this ongoing initiative, the role of BCSIC, which it mostly failed to carry out, will become even more limited in the coming days.

iii) SME Foundation

The SME Foundation became functional with 24 staffs in 2008 following government gazette dated August 7, 2007. The number of staffs is now about 60. The Foundation is capitalized by the government of Bangladesh with a total endowment of Tk. 2 billion. The interest earning on this endowment fund is the sole source of finance for different activities undertaken by the Foundation. The Foundation works through different wings which are described below.

A. Policy advocacy wing

The primary goal of this wing is to facilitate change and create, if required, new policies in order to tackle unmet and emerging need of the SMEs. It also works to identify and address the challenges for small and medium entrepreneurs in legal and administrative regimes like regulatory barriers relating to trade license, patent and trademark, product certification, environmental issues etc.

B. Credit wholesaling wing

Credit wholesaling is one of the major activities of SME Foundation to ensure easy access to finance for the SME entrepreneurs. SME Foundation has already taken credit wholesaling program as pilot scheme with its own fund. SME Foundation helps the SME entrepreneurs by providing collateral free loan at 9% interest rate. This collateral free loan is directed mainly towards technology based potential SME manufacturing industries and agro-based industries.

C. Capacity Building & Skill Development

This wing organizes training program in public-private partnership module to enhance the skill of SME entrepreneurs and also to create new entrepreneurs. Training programs include entrepreneurship development, and training related to SME cluster wise skill, technology, ICT, training of trainers, productivity and quality improvement, marketing, management, financial management etc. The trainings are conducted by signing MoU between SME Foundation and training institute or SME related association. Besides, SME Foundation also assists trade bodies/ associations to develop their skills.

D. Access to Technology

This wing works to improve competitiveness of SMEs through technology up-gradation, adaptation of advanced technology, diffusion of appropriate technology, moving towards reverse engineering, and compliances and product certification. SME Foundation is also devoted to enable SMEs to become energy efficient and environmentally sound.

E. Access to Information

This wing works to provide updated information and data through its own web portal (<http://www.smef.org.bd>) to the government, planner, decision maker, executive, researcher, investor, policy maker and to the SME entrepreneurs to establish new business or run business in a profitable manner. Establishment of a data bank with different information, data, findings and strategy for the development of SMEs at local and international level is an important activity of SME Foundation.

F. Women Entrepreneurship Development

This wing works to bring the women entrepreneur to main stream development process. Facilitating them for women empowerment is one of the prioritized activities of SME Foundation. Main activities include institutional capacity building of women chambers and trade bodies, formulating gender action plan, encouraging bankers to finance women entrepreneurs, conducting study on women entrepreneurs, and organizing women entrepreneur conference, national SME women entrepreneurship award, SME product fair for women entrepreneurs etc.

G. Business Support Service

This wing provides diverse kinds of business support services for entrepreneurship development. These include promotion and market expansion of SME product, establishing linkage between

buyer and seller, providing advice and guideline with information support for new business development, publishing SME business manual, and organizing SME product fair etc.

The main strategies followed by the Foundation are as follows:

Strategy- 1: Strengthen regulatory and legislative framework in favor of SMEs

Strategy- 2: Identify problems & prospects of SMEs/SME sectors/SME cluster for designing appropriate development interventions

Strategy- 3: Ensure availability of business support services for SMEs

Strategy- 4: Access to institutional finance for SMEs

Strategy- 5: Up-gradation and adoption of appropriate technology for SMEs

Strategy- 6: Develop human resources for SMEs

Strategy- 7: Adaptation of Information and Communication Technology (ICT) in SME Development

Strategy- 8: Position women entrepreneurs into the mainstream business community

Strategy- 9: Cluster based SME development

Strategy- 10: Institutional linkage for SME development

Although established in 2007, the Foundation is yet to make a functional mark in the development of SME development. A number of factors are responsible for it which are discussed later. Notwithstanding these constraints, some of the activities carried out by the Foundation are discussed in Box 1.

In SME policy 2005, the SME Foundation was envisioned to be the ‘one-window service delivery center’ for small and medium enterprise based development. However, the foundation is yet to emerge as a service center for SMEs as originally envisaged. A ‘strength, weakness, opportunities and threats (SWOT)’ analysis is carried out to evaluate the current situation of SME Foundation in Box 2.

Box 1: Activities carried out by SME Foundation

The SME policy 2005 identified 11 booster sectors for providing support through SME foundations. However, considering the limited manpower and financial resources, the SMEF governing board reduced the list to six sectors for the foundation to work. They include: (i) Electronics and electrical products, (ii) Light engineering and metal-working, (iii) Agro-processing, (iv) Plastics and other synthetics, (v) Leather goods, and (vi) Fashion-rich personal effects, wear and consumption goods.

The SME Foundation conducted sectoral studies on these six sectors by engaging external consultants and prepared a time-bound action plan with prioritized recommendations through a 'National Consultation on SME Development' in 2012. In addition to this overall action plan, a sector specific action plan has also been prepared for each of these six sectors. While the preparation of these action plans is a welcome step, their implementation process is yet to fully begin. The implementation is constrained by the absence of any clear guideline regarding institutional collaboration and mandate of different relevant organizations.

In the absence of in-house capacity, the SME Foundation collaborates with other organizations. For example, in order to promote technology transfer in light engineering and metal-working, the SME Foundation collaborates with Bangladesh Industrial Technical Assistance Center (BITAC) to impart training to create a pool of skilled people. One of the main hindrances to technology transfer is the lack of skilled personnel, and creation of a pool of skilled workers with relevant technological knowledge is expected to overcome this problem.

Similarly, to promote access to markets, both at domestic and global, the agro-processing SMEs need to comply with ISO 22000. Neither the SME foundation nor any other organization has the expertise to train the entrepreneurs on this. Due to this vacuum, the SME foundation hired a lead expert from Asian Productivity Organization, to train the entrepreneurs as well as some trainers who can train more entrepreneurs later. There is no designated testing facility available in Bangladesh for Electronics and electrical products to ensure their standard and quality. The SME foundation prepared a project proposal with the help of the Bangladesh University of Engineering and technology (BUET) to develop such a facility in the country. The project proposal has been submitted to government and the financial resources for it are yet to be mobilized.

Although Plastics and other synthetics has been identified as one of the booster sectors in the country, there is no dedicated institute to provide technical and human support to this sector. The SME foundation has developed a proposal to set up 'Bangladesh Institute of Plastic Engineering and Technology (BTPET)'. This proposal has been approved by the government and Taka 100 million has been already approved for it in FY15 budget. The foundation is also providing training to the leather and fashion-rich personal effects, wear and consumption goods. They have identified 147 SME clusters at different parts of the country which has the potential to become a 'quick win'. Although the foundation does not receive any financial support as such for credit wholesaling, it has started this to a limited extent by using its own savings after meeting the operational expenses from the interest earned on its endowment funds.

Box 2: A SWOT analysis of SME foundation

Strength

Legal mandate with single mission of developing SMEs in the country

As per the government gazette, the SME foundation is entrusted with the power to work independently for the development of SME sector of the country. The mission and objective is very well-defined and approach to be followed to accomplish them is also well-identified.

Diversified manpower commensurate with heterogeneous facets of development of SMEs

Although the current manpower of the foundation is not adequate, the composition is commensurate with the multi-faceted task requiring expertise on finance, economics, public relations and engineering for the development of SME sector. There are about 44 full time staffs currently working in the foundation. They came with diverse background, from engineering to social science. It enables the foundation to undertake a holistic approach for the development of SMEs.

Weakness

Inadequate finance

Total financial resource available to the foundation is inadequate and also volatile. The foundation received an endowment fund of Tk. 200 core. Interest earned on this fund is the sole source of finance. The earning on this endowment is inadequate to undertake different activities by the foundation as mandated in the government gazette. Total proceed earned from the endowment fund depends on the market rate of interest which varies over time. This makes the overall planning difficult for the foundation.

Inadequate legal backing

Although SME foundation was envisioned as 'one stop service' provider in the original planning, it is not provided with the adequate legal authority over other relevant organizations, let alone bring them under one umbrella. Although the foundation has the mandate and is better placed to undertake certain activities, these are taken up by other organizations without involving the foundation. The credit wholesaling is one example. The foundation is better informed about the SME clusters and their composition and need for credits. But it is not involved in the credit program administered by Bangladesh Bank, which lacks the sectoral knowledge.

Opportunities

Adequately sensitized environment and political endorsement

The importance of SME sector is well recognized in all planning documents. Starting from the 2005 policy paper to 6th five year plan, all medium and long term plans acknowledged the potential role of SMEs to enhance growth and poverty alleviation in the country. The formation of the SME foundation itself reflects the commitment of the government to the development of a vibrant SME sector. All these provide a favorable ground for SME foundation to pursue its mandate.

Adequately conducted background work

Notwithstanding its limited resources, the foundation has conducted a reasonable amount of background work to identify the problems and prospect of the SME sectors. The foundation has identified different naturally developed SME clusters with different needs for further development. A number of actions have also been identified based on these studies. All the foundation needs is to enhance the efforts and successfully implement these activities leading to some example of success

Threat

Although the SME foundation was set up in 2007 with a number of objectives as its mandate, it is yet to mark notable success. The required institutional reform and support required for an effective and functional are not foreseen. If this situation continues, the foundation will not be able to accomplish the objectives of developing a vibrant SME sector as envisioned in different planning documents of the government.

i. Bangladesh Bank

To develop SMEs, Bangladesh Bank has introduced several schemes and programs to ensure institutional financial services for the SMEs. They include credit wholesaling by using the grants received from different development partners, opening of ‘Dedicated Desk’ and ‘SME Service Centre’ in the banks and special services for the women entrepreneurs. The sole responsibility of the newly established ‘SME and Special Programs Department’ of Bangladesh Bank is to formulate policy, facilitate credits and monitor the development of small and medium entrepreneurship. This new department formulated guideline for compliance of the banks and financial institutions (FIs) as follows:

- Bangladesh Bank sets an indicative target for SME loan disbursement for a year and involve closely with the banks and financial institutions to achieve it. According to the target, SME loan shall be disbursed to the small, medium and women entrepreneurs.
- Following the 'Area Approach Method', banks and financial institutions try to attain their indicative targets separately by dividing it by branch, region & sector.
- Each bank/financial institution is allowed to follow a separate business strategy in financing SME loan with least formalities in executing documentation to ensure easy and speedy loan sanction and disbursement process.
- For small entrepreneurs credit limit will range from Tk. 50,000 (Fifty thousand) to Tk. 50,00,000 (Fifty lac). At least 40% of the total disbursement target of SME credit should be reserved for small entrepreneurs and the rest will be for medium ones. Priority is given to potential women entrepreneurs in respect of SME credit disbursement.
Each bank and financial institution is supposed to establish a separate ‘Women Entrepreneurs’ Dedicated Desk’ with necessary and suitable manpower, provide them training on SME financing and suitably appoint a lady officer as chief of dedicated desk. Banks and financial institutions may approve up to Tk. 25,00,000 to women entrepreneurs against personal guarantee. In that case, group security/social security may be considered. Overall, 15% of the total SME credit would be given to women entrepreneurs.
- The success in SME loan disbursement is considered as yardstick for further approval of new branches of the concerned bank. License for New Branches will be issued for financing the priority sectors like SME and agriculture from 2010 in the name of ‘SME/Agriculture Branch’ instead of ‘SME Service Centre’ in order to involve banks in financing priority sector like SME and Agriculture’.
- Each bank/financial institution is allowed to set the interest rate on SME loan sector/subsector wise. However, in case of women entrepreneurs it would be bank rate + 5 percent, not exceeding 10 percent.

In providing credit to SME, Bangladesh Bank follows the definition recommended by Better Business Forum as shown below:

Small Enterprises are firm/business but not a public limited company and should have the features given below:

Serial Number	Sector	Fixed Asset other than Land and Building (Tk.)	Employed Manpower (not above)
1	Service	50,000-50,00,000	25
2	Business	50,000-50,00,000	25
3	Industrial	50,000-1,50,00,000	50

Medium Enterprises are the establishment/firm and should have the feature given below:

Serial Number	Sector	Fixed Asset other than Land and Building (Tk.)	Employed Manpower (not above)
1	Service	50,00,000-10,00,00,000	50
2	Business	50,00,000-10,00,00,000	50
3	Industrial	1,50,00,000-20,00,00,000	150

Different credit wholesaling (refinancing schemes) initiatives undertaken by Bangladesh Bank are as follows:

A) Refinance for Small Enterprises

46 banks and non-bank financial Institutions have signed a participation agreement with Bangladesh Bank for financing the SME sector under following schemes:

i) Bangladesh Bank Fund (BB Fund): A refinance scheme of BB, named Small Enterprise Fund (SEF) with amount of Taka 6.0 billion has been providing support for the development of small enterprises in the country. The scheme was extended for the banks and financial institutions at bank rate against their financing to the small entrepreneurs. The scheme demonstrated a high market demand. Recovery against refinanced loan is being used as a revolving fund for financing SME sector. An amount of Taka 20.0 billion (including women fund) has been refinanced to 22 banks and 22 financial institutions until the end of June 2014 to support 22321 enterprises.

ii) Enterprise Growth and Bank Modernization Program (EGBMP) Fund: In 2004, the IDA Wing of the World Bank provided an additional amount of USD 10.0 million to EGBMP fund to reinforce this scheme under a development credit agreement signed with the Government of Bangladesh for financing the development of small enterprise sector of the country. In addition, the Government of Bangladesh allocated an amount of Tk.0.6 billion under the said agreement.

An amount of Tk.1.2 billion has been received combining the IDA credit fund and Government of Bangladesh fund for refinancing. Out of this fund, an amount of Taka 3.1 billion has been provided to 32 banks and Financial Institutions (FIs) against 3160 enterprises on revolving basis. Disbursement from this fund was completed in June 2011. Until end of June 2014, Taka 3.0 billion has been recovered; and, thereby, Tk. 0.1 billion remains outstanding with the FIs.

iii) ADB Fund-1: “Small and Medium Enterprise Sector Development Project” was launched in 2005 financed by ADB-1 fund. Asian Development Bank initially provided an amount of USD 30.0 million for financing the scheme under a loan agreement with the Government of Bangladesh to strengthen the SME sector in Bangladesh. An amount of Taka 3.4 billion was provided to Banks and FIs under the first ADB fund until September 2009 against 3264 enterprises. Disbursement from this fund was completed in September, 2009. Until end June 2014, Taka 3.3 billion has been recovered; and Taka 0.01 billion remains outstanding with the FIs.

iv) ADB Fund-2: The Small and Medium-Sized Enterprise Development Project (SMEDP) provided credit facility for enhancing medium to long term financing to eligible SMEs. The total fund of the SMEDP (ADB-2) was USD 95.0 million. Out of that, ADB provided USD 76.0 million from its special fund and GoB (BB) provided USD 19.0 million which was transferred from the balance of the earlier ADB-1 (SMESDP) fund. Disbursement from this fund was completed in December 2013 and Taka 7.5 billion was provided to banks and FIs against 13645 enterprises. At the end of June 2014, Taka 2.6 billion has been recovered; and thereby, Taka 4.8 billion remains outstanding with the FIs.

v) JICA Two Step Loan Fund: Bangladesh Bank has been implementing the “Financial Sector Project for the Development of Small and Medium-Sized Enterprise (FSPDSME)-BD-P67” project under the loan agreement between JICA, Japan and the Government of Bangladesh. The objective of the project is to create a medium to long term financing market for SMEs especially for the productive investments. The Fund size is 5000 million Japanese Yen (JPY), including a technical assistance component. The principal component of the fund is two step loan of JPY of 4787.5 million. 25 banks and 21 FIs signed participating agreements with Bangladesh Bank so far. As on June 2014, an amount of Taka 2.0 billion has been refinanced as against 271 enterprises. Of the total refinanced amount, Taka 0.3 billion has been recovered until end June 2014 and the remaining outstanding balance with the FIs is Taka 1.7 billion.

In the backdrop of tragic incidence of Rana Plaza collapse and recent crisis in the RMG and Knitwear sector, a special initiative to finance for the improvement of working environment of RMG and knitwear sector workers was taken under the JICA assisted FSPDSME project. RMG and Knitwear factories which are members of BGMEA and/or BKMEA with labor employment of 100-2000 provided that the factory building is owned by the applicant entrepreneur will get loan facility up to Taka 10 crore for the purpose of retrofitting, rebuilding and relocation of their factory buildings. This Two Step Loan (TSL) fund for RMG and knitwear factories of FSPDSME scheme will support 100.0 percent of the sub-loan amount as pre-finance. Up to end

June 2014, two RMG industries belong to BGMEA and BKMEA have been selected for retrofitting purposes in the first phase.

B) Refinance Scheme for Agro-based Product Processing Industries

Bangladesh Bank launched a scheme of Taka 1.0 billion in November 2001 out of its own fund for financing the agro-based product-processing industries in the areas outside Divisional Head Quarters and Narayanganj town. The size of the fund increased to 2.0 billion in 2012; and later to 4.0 billion in 2013. Refinancing facilities are provided to banks and financial institutions at the bank rate. An amount of Taka 5.0 billion has been disbursed under this scheme until the end of June 2014 against 1897 enterprises on revolving basis.

C) Refinance to Women Entrepreneurs

Bangladesh Bank is encouraging all banks and FIs to provide loan to women entrepreneurs at 10.0 percent interest rate. Banks and FIs were instructed to reserve 15.0 percent of total SME funds exclusively for women entrepreneurs. An amount of Taka 8.2 billion has been refinanced to women entrepreneurs until the end of June 2014 against 10214 enterprises.

D) Refinance Fund for New Entrepreneurs under Cottage, Micro and Small Category

In order to provide start-up capital to new cottage, micro and small enterprises, Bangladesh Bank has created a new fund worth of Taka 1.0 billion from its own source. Under this fund, the prospective entrepreneurs selected and trained by recognized public and private training providers will get financing facilities at 10.0 percent interest rate (bank rate +5%). Refinancing from this fund will start soon.

VIII. The effectiveness of the existing policies and institutions

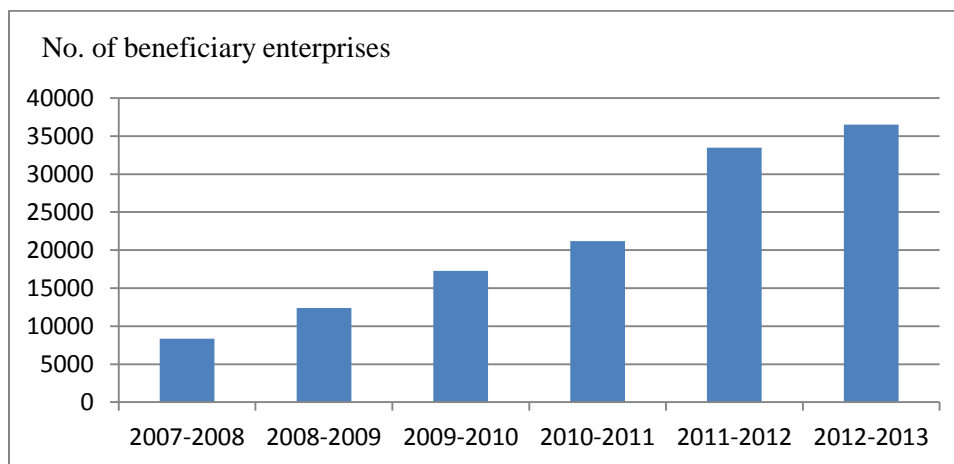
There has not been any rigorous research to evaluate the efficacy of the current support structure for the SME development. In the absence of any firm-level analysis, one way to evaluate the role of the current support system would be to look at whether the establishment of new institution like SME Foundation or policy shift to address some of the binding constraints like revised credit policy for SME had resulted in any structural break in the performance indicators of the SME sector. In addition to this result-based evaluation, another approach would be an evaluation of whether delivery of services for SME had notably increased or not.

One of the key constraints faced by SME has been the lack of financing due to difficulties in accessing conventional financial market. In the presence of a well-functioning capital market, small and medium enterprises should be able to collect the funds they need to cover production costs and repay them with interest by selling their products. Since such a smoothly functioning capital market is missing, the government has to ensure increased access to credit for small and medium enterprise to correct the market imperfection. A number of studies reported that small and medium entrepreneurs not only pay high interest on loan compared to the large

entrepreneurs, they also face a number of non-pecuniary problems in getting the loan from the bank, which increases the transaction cost of fund for them. They include long waiting period for getting initial finance from banks due to tedious paper works, inability to provide collateral to get loans, inexperience in preparing financial system (Khandker 2014), high interest rate, too much paper work, lack of proper communication skill (Chowdhury et al. 2013).

Whether the difficulties in accessing finances due to these transaction cost and the consequent sub-optimality in overall resource allocation from national point of view, have been adequately reduced or eliminated can be evaluated by the amount of loan disbursed and/or number of beneficiaries. Figure 1 shows the number of SME beneficiaries that took loan from different financial institutions during the period 2007/08 – 2012/13. The special credit program of Bangladesh was introduced in 2009-10. As can be seen from Figure 1, the number of beneficiary enterprises has significantly increased since 2009-10, especially during 2011-12 and 2012-13.

Figure 1
Number of small and medium enterprises accessing credit programs



However, a close examination reveals the increase in these years is attributable to introduction of a new window of credit targeting a new client group- the women entrepreneurs. This group of entrepreneurs is provided with credit at a single interest rate while the other entrepreneur pays as high as 18% rate of interest. Since the number of women entrepreneurs is very limited, this channel has very limited scope to disburse more credit.

Table 8 presents the information on total disbursement of credit during 2009-2013. In 2009, total amount of credit disbursed to SME sector was 12.45 billion BDT, which increased to 28.89 billion BDT in 2013, registering an annual average growth of about 33 percent. To put it in

perspective, this growth rate is significantly higher than the growth of overall private credit in the country. As can be seen from the Table, a number of factors contributed to the growth of SME credit in the recent years. One of them is the increase of availability of funds with the sanction of second tranche of funds by Asian Development Bank, and joining of JICA in the provision of funds for SME. Another reason is the renewed efforts of the Bangladesh Bank to provide credits to women entrepreneurs of SME sector. About 3.8 and 5.2 billion taka have been disbursed as credit among the women entrepreneurs in 2012 and 2013 respectively.

Despite the recent increase of overall disbursement, access to finance is still identified as a main constraint by 68.6 percent of the small and 44.7 percent of the medium entrepreneurs (INSPIRED SME Survey 2013). This indicates that there is still a dearth of credit and the small entrepreneurs suffer relatively more from it.

The current institutional arrangement of Bangladesh Bank has created incentives for the banks and non-bank financial institutions to provide more credit to SME but there are not enough safeguards to ensure appropriate targeting. This, by taking the advantage of missing monitoring, can lead to moral hazard problem.

Banks and financial institutions receive the funds at a rate of 5% interest from Bangladesh Bank. The average interest rate on loan disbursed to SMEs is 15.6% (INSPIRED SME Survey 2013), implying a spread of 10.6%, whereas in case of normal fund the same spread is around 5 percent. This provides the incentive to the contracted banks and non-bank financial institutions to disburse credit by using funds from the refinancing schemes and may result in inadequate attention to proper targeting. There has not been any study to assess to what extent truly qualified entrepreneurs have benefitted from the credit programs of Bangladesh Bank. Since SME foundation has a better knowledge about this sector, collaboration between Bangladesh Bank and this foundation can potentially result in better cluster and sectoral targeting for SME credit.

We noted earlier that the employment size classes in the Economic Census, SMI 2005-06 and SMI 2012 are different from each other and hence a concrete assessment of growth of SME during recent years cannot be made. However, the broad picture that emerged from the evidence suggests that the SMEs in general and the manufacturing SMEs in particular experienced significant growth in their employment and establishment share during the past decade. Thus, Economic Census data showed that manufacturing units with 10-99 workers increased at a yearly compound rate of 5.6% during 2001/03 to 2013 while the SMI data showed that employment in manufacturing enterprises with 20-49 workers increased at a yearly compound rate of more than 9%. This would suggest that the strengthening of the SME credit program in recent years has been largely successful in stimulating growth of SME in Bangladesh.

Table 8**SME Refinancing (June 2009 - February 2013)**

	Name of Banks/ELs	Amount Refinanced (crore Taka)				No. of Refinance Beneficiary Enterprises			
		Working capital	Midterm loan	Long term	Total	Industrial loan	Commercial loan	Service	Total
2009	Bangladesh Bank	178.48	336.40	201.56	716.44	1724	4150	1127	7001
	IDA	61.51	96.40	66.59	224.50	899	1220	358	2477
	ADB	138.68	112.82	52.75	304.25	728	1864	331	2929
	Total	378.88	545.62	320.90	1245.20	3351	7234	1816	12401
2010	Bangladesh Bank	235.00	555.83	250.85	1041.67	2804	6651	1743	11198
	IDA	64.44	112.80	93.84	271.38	981	1306	486	2773
	ADB	144.48	132.27	58.19	334.94	800	2096	368	3264
	Total	444.22	800.90	402.88	1648.00	4585	10053	2597	17235
2011	Bangladesh Bank	274.11	673.72	288.33	1236.16	3786	8061	2022	13869
	IDA	80.34	132.47	99.80	312.61	1368	1306	486	3160
	ADB	144.48	168.71	68.70	381.89	919	2796	447	4162
	Total	498.93	974.90	456.83	1930.66	6073	12163	2955	21191
2012	Bangladesh Bank	337.59	755.78	322.83	1416.25	4713	8696	2441	15850
	BB- Women Entrepreneur Fund	57.88	223.41	100.13	381.42	1784	2741	737	5262
	IDA	80.34	132.47	99.80	312.61	1368	1306	486	3160
	ADB-1	144.48	132.27	58.19	334.94	800	2096	368	3264
	ADB-2	-	226.47	63.33	289.79	1527	3461	942	5920
	Total	620.29	1470.4	544.48	2735.01	10192	18300	4974	33456
2013	Bangladesh Bank	346.15	574	239.65	1159.8	4456	5898	1759	12113
	IDA	80.34	132.47	99.8	312.61	1368	1306	486	3160
	ADB-1	144.48	132.27	58.19	334.94	800	2096	368	3264
	ADB-2	-	417.52	118.34	535.86	2643	6377	1768	10780
	JICA	17.52	7.31	0.33	25.16	19	18	1	38
	Women Entrepreneurship Fund	90.4	300.8	129.3	520.51	2551	3562	1011	7124
	Total	678.89	1564.37	645.61	2888.88	11837	19257	5389	36483

IX. International Experience in SME Development

i. Lessons from the Experience of SMEs in the Newly Industrialized Economies (NIEs or Tigers)

The following assessment of the lessons learnt from NIE experience of SME development was made by the South Asia Enterprise Development Facility (SEDF) – an outfit of the International Finance Corporation of the World Bank set up to support SME development in South Asian countries (SEDF 2003).

Though there is no clear evidence from NIEs to suggest that prioritization of SMEs was a prerequisite for economic growth and/or poverty reduction, in some cases the SME sector was the driving force, whilst in other cases it followed developments such as export-oriented large enterprises. In fact, in each of the Tiger economies (with the exception of Hong Kong), large foreign and/or domestic enterprises have played a key centre or anchoring role in the growth process, with SMEs linked closely as their downstream suppliers. For example, in Taiwan, centre firms have supported SMEs by providing equipment or collateral for subcontractors, while subcontracting between SMEs has encouraged business linkages that have enhanced sector efficiency and productivity.

Thus the overall conclusion might be that the key to the success of the Tigers was a clear understanding of their respective endowment advantages and the implementation of policies that favored these. Within this, there is evidence of a well-developed understanding of the appropriate role for the SME sector as a component of overall policy, and the pursuit of measures that helped SMEs fulfill the sector's specifically required role. Patterns of evidence also suggest the following.

Governments created an environment where entrepreneurship could flourish. In Taiwan post 1960, a series of statutes to encourage investment was promulgated.

Such general measures were supplemented by the prioritization of favored industries. For example, from the 1980s onwards, the Taiwanese government developed industrial parks, and encouraged the creation of geographic and sectoral clusters of SMEs, by targeting specific industries. Foreign firms were encouraged to locate but were strictly controlled, with Foreign Direct Investment (FDI) being allowed only in target industries, and only firms with a technology to transfer permitted to locate.

In all cases where the SME sector experienced significant growth, and despite the undoubted importance of financial services, non-financial instruments emerge as the primary stimulants. A range of approaches was evident, including well-targeted technology transfer, and the fostering of forward and backward linkages. Financing mechanisms were then developed to support this growth.

The rapidly growing SME sectors in the Tigers generally focused on labor intensive activities that employed more lower-skilled workers than did large enterprises (for example, in 1989 in Taiwan the average capital/labor ratio was 1.305 in large enterprises and 0.187 in SMEs). Consequently, SMEs were a major source of employment creation (in China, Japan, Taiwan, Thailand and Vietnam, SMEs account for over 70 percent of total employment) and so, seemingly, played a major role in poverty reduction.

The relationship between SME growth and poverty reduction does not appear to be uniform. For example, the very high importance of SMEs to growth in Hong Kong does not seem to have had the same income redistributive effects that emerged in Taiwan. This indicates that specific policy measures have determined the degree to which SME development contributes to poverty alleviation.

Another key characteristic of SME development in the Tigers was the highly integrated nature of the policy environment. It was understood that SMEs had vital and often differing roles to play if maximum use was to be made of a country's natural endowments, and that these roles had to relate effectively to other sectors of the economy. It was also understood that SMEs required a comprehensive range of support instruments, encompassing financial and non-financial factors, birth and growth processes, and technical aspects. The drivers for SME development, such as FDI from TNCs or export market opportunities were identified and appropriate support measures were taken. The more targeted approach taken by the NIE governments also enabled them to concentrate on technology transfer that fostered the SME sector.

The NIE experience also suggests that emphasis should be placed on a cluster-based development approach, supporting both local, bottom-up clustering and upgrading "clustered sectors" of key national relevance, and maximizing the value of forward and backward linkages consistent with coherent industrial policy.

Recognizing the degree to which policy integration and comprehensiveness of support measures were fundamental to success in the Tigers, it is essential that SME policies are supported by "road maps" that clearly prioritize and sequence the actions to be taken in pursuance of agreed strategy.

Whilst it should be possible to make short-term impact, the NIE experience suggests a medium term perspective, which sees the evolution of an SME support infrastructure in accord with the development of the sector itself.

As a key aspect of this medium-term perspective, high priority must be given to training and development of the human resource base. There must be a focus on developing a population base that is motivated and able to create new businesses and another with the technical skills required by the growth sectors.

ii. UNIDO experience in promoting cluster- based SME development

The term “cluster” is used to indicate a sectoral and geographical concentration of enterprises which produce and sell a range of related or complementary product and are, thus, faced with common challenges and opportunities.

These concentrations give rise to external economies (such as the emergence of specialized suppliers of raw materials and components or the growth of a pool of sector-specific skills) and favor the emergence of specialized services in technical, administrative and financial matters. Clusters are also a conducive ground for the development of a network of public and private local institutions which support local economic development promoting collective learning and innovation through implicit and explicit coordination.

The United Nations Industrial development Organization (UNIDO) made the following assessment of its experience in implementing cluster development projects for SMEs in Honduras, Nicaragua, Mexico and Jamaica during late 1990s (UNIDO 1999).

The UNIDO report noted that in spite of the potential benefits for the enterprises, inter-firm cooperation and the other features of successful clusters do not always emerge spontaneously. The main factors hindering this process include a) the frequently high transaction costs that need to be borne to identify suitable cluster partners and to forge relationships; b) the imperfect functioning of the markets for such crucial inputs for cluster development as information and innovation; and c) the high risk of “free riding” faced especially where the legal framework to back up joint endeavors is relatively underdeveloped.

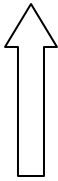
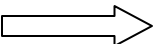
The UNIDO experience, however, illustrates vividly that the intervention of an external agent acting as a catalyst to facilitate the emergence of clusters can greatly reduce the significance of the above factors. The following were identified as important factors for SME cluster development to succeed.

- An important principle in the design and provision of cluster development is demand orientation. In UNIDO’s experience, project strategies must be flexible and vary from cluster to cluster, depending on the nature of the constraints and objectives of the client base. One important requirement is that the intervention must be designed after a thorough analysis of the needs of the client base and the surrounding economic environment from which resources can be tapped to satisfy those needs.
- The key resource in cluster initiative is the people involved. With this in mind it is important that at all levels the project actors must own the project and feel it is in their interest to execute it To this end, it is important to invest adequately in raising awareness at all levels, to involve local actors in project design, and continue their continual feedback for improving project implementation.

- The introduction of elements of market cost recovery should be pursued as early as possible in order to avoid that the beneficiaries become accustomed to full subsidies and risk that the enterprise becomes dependent on the service provider.
- The importance of continuous training as well as the need to diffuse information related to best practices to orient cluster agent's decision is most important. In UNIDO's experience, the kind of training that has emerged as valuable and effective is to rely heavily on concrete cases of successful clusters and let cluster agents hear directly from other agents who have successfully implemented cluster projects.

X. Elements of a Strategy for SME Development

This paper proposes a three-step strategy to be played to develop the SME sector of the country. The first step relates to the consolidation of the naturally developed capabilities mainly serving the domestic market. The second step relates the facilitation of their entry into the export market. The third step relates to the enhancement of capacities to thrive into the global market. The first role of the proposed strategy is protectional; protecting the naturally developed capabilities. The role in the second and third strategy is promotional; promoting the capacities of the SMEs to penetrate into the export market and thrive withstanding the global competition. Schematically, this is illustrated below.

Steps 			Thriving in global market
		Diversifying into export market	Promotional role
	Consolidation of current strength		
Roles 	Protectional role		

Under this broad thematic scheme, the following specific components of the strategy are proposed.

i. Selective approach to SME development

Faced with factor prices closer to their social opportunity cost, smaller enterprises are often more efficient users of resources and tend to be more labor intensive in labor surplus economies. Low capital, skill, and technology content also enable the smaller enterprises to be geographically more dispersed. These attributes thus render these enterprises more supportive of poverty-reducing development strategy.

However, the empirical evidence on the performance of smaller enterprises around the world has been a mixed one and the optimal size of the enterprise has been found to vary across activities.

The observed differential performance of the smaller enterprises has led to some qualifications to the broad approach towards development of these enterprises.

The purview of smaller enterprise development has been extended to include medium sized enterprises with somewhat reduced emphasis on tiny or micro enterprises. Instead of an across the board strategy of SME development, policies towards these enterprises are now to be based on a positive, developmental attitude seeking to promote efficiency and growth. There is increasing realization that the thrust of SME development will have to be on "modern" SMEs that have higher growth potentials compared to the "traditional" SMEs.

The evidence presented in this paper has shown that economic units, particularly the manufacturing units at the bottom of the size scale (less than 10 workers and 10-24 workers) account for a significant proportion of economic units and employment outside household agriculture. At the other end, large enterprise with 250 or more workers account for a significant part of employment and value added, particularly in the manufacturing sector. This conventional U shaped dualistic look of the manufacturing sector seems to be on the decline in Bangladesh.

The evidence has shown that economic units particularly manufacturing units at the extreme end of the size scale (less than 10 workers) have been experiencing a declining trend in their employment share within the overall economy. The productivity levels in these enterprises have also stagnated over the years.

In contrast, a core dynamic component in the small industry group seems to have undergone considerable modernization taking advantage of trade liberalization measures and raised both fixed assets per worker and labor productivity and has been successful in bringing under its fold a larger segment of the domestic market and also making foothold in the export market. This has resulted in narrowing down of the spread with respect to capital intensity and labor productivity between small and large industry reflecting upward mobility on the part of the modern component of the small industry group.

Hence, an essential element of a strategy for the development of the SME sector in Bangladesh will involve identifying niches where small and medium enterprises have comparative advantage and higher growth potential. This will mean exploring market opportunities on a sustained basis and mobilizing the required support services for the promotion of these industries once such niches are identified.

Collection and analysis of the relevant industry related information will be an essential prerequisite for such strategic planning. It is with this purpose that the government has set up the SME Foundation whose mandate is to work out such development strategies for the SME sector in Bangladesh on a continuing basis in close tandem with the private sector. The capacity and activities of the SME Foundation needs to be strengthened to this end.

ii. Creating an enabling environment for private investment

Past experiences of the performance of the SME sector in Bangladesh clearly shows that when private investment faces a weak enabling environment it causes a stronger adverse impact on the growth prospects of SME. Therefore, any discussion on the constraints faced by SME and commensurate development strategy for SME in Bangladesh needs to be undertaken along with an assessment of the overall enabling environment pertaining to private investment in the economy.

Constraints that contribute towards a weak enabling environment for private investment can be grouped under three broad headings: (i) policy induced constraints, (ii) structural constraints, and (iii) constraints arising out of poor business support services and weak governance. In facilitating development of the private sector and SME, the primary role of the government will have to be to create investment friendly law and order situation, supportive legal and regulatory framework and appropriate macroeconomic policies. These will need to be complemented by prioritized public investment designed to ease various structural bottlenecks pertaining to physical and infrastructural facilities, energy, and technology. In addition, the quality of governance will have to be improved to ensure reliable supply of basic services on which honest and efficient businesses depend.

iii. SMEs need a differentiated and hassle free indirect tax system

Given the structural difference between the SMEs and their large-scale counterparts, there is a case for a differentiated system of indirect tax for the SMEs that will enable them to pay the indirect tax free from harassment. A graduated system of turnover tax can be designed for the SMEs for this purpose. Critics argue that a differentiated system will discourage SMEs to grow larger in a bid to avoid getting under the VAT net and that a system of turnover tax makes them less attractive suppliers of inputs to other firms who need VAT certificate for input to adjust their

own VAT liabilities. However, if the cut-off size limit is sufficiently large to include all SMEs, and the turnover tax is appropriately graduated than the problem of growth disincentive will not be a serious one. On the other hand, the problem of VAT certificate may be resolved by creating a notional VAT equivalence of the turnover tax.

iv. Easier access to imported inputs

As explained earlier, one of the key factors facilitating rapid growth of a number of small and medium industries was access to imported inputs at lower cost due to reduction of import duty. After the initial rapid pace of liberalization in the early 1990s, the process slowed down and during the past decade, wide spread use of para tariff reverted to some extent the benefit SMEs gained initially. A strategy for the development of the SME sector in Bangladesh, therefore, needs to be premised on further trade liberalization measures with a view to providing SMEs easier access to imported inputs.

v. Targeting public expenditure towards augmenting demand

One important factor affecting the growth of SMEs has been the trend in domestic demand. Thus, the rapid growth of the construction sector seems to have contributed to the expansion of SMEs producing non-metallic mineral products, particularly bricks, structural clay and cement products. Public expenditure directed particularly towards the agricultural and the rural sector would raise the purchasing power of the rural people. Since the demand structure of this segment of the population is more oriented to local products, it would act as a stimulus to growth and expansion of SMEs.

vi. Access to credit

The Sixth Five Year Plan recognized availability of credit as one of the most important factors for SME development. Accordingly, the Plan included the following measures for addressing the credit need of the SMEs.

- The comprehensive credit policy for SMEs developed by the Bangladesh Bank constituted a key element of the Plan measures. Under this policy, the commercial banks and other financial institutions are required to disburse SME credit according to the target set by Bangladesh Bank and send disbursement report to Bangladesh Bank.
- Following Bangladesh bank guideline, area and cluster approach is to be adopted in SME credit disbursement.
- To strengthen targeting of SME credit, the Plan provided for (i) a census of SMEs containing detail information on inputs, output, technology and management, (b) issuing identification card with registration number to the SMEs, (iii) creating a database of

SMEs and updating it periodically, and (iv) creation of detail upazila level map of SMEs to identify cluster.

- The financial institutions will be required to develop loan products that relate better to specific type of credit needed in SMEs.
- Provision of subsidized credit to clusters, disadvantaged groups and backward regions with close monitoring.
- Training of bank officials and setting up of SME cells for identifying potential borrowers, loan disbursement, monitoring use of credit and collection of loan.
- PKSf will continue to wholesale credit to its partner NGO-MFIs for small and micro enterprises.

In line with the measures delineated in the 6th Five Year Plan, credit disbursement to SMEs has been geared up following Bangladesh Bank guidelines and as mentioned earlier the volume of SME credit disbursed has increased significantly with visible positive impact on the growth of the sector. However, one aspect on which little progress has been made is with regard to strengthening targeting of SME credit. A prerequisite for this is the creation of SME database, which would help assess the relative growth potentials of diverse SMEs and enable proper targeting of SME credit in line with the earlier suggestion of selective SME development strategy.

Another lopsided feature of the SME credit, particularly those under Bangladesh Bank's refinancing scheme is the predominance of trade and other service activities as opposed to manufacturing amongst the credit recipients. Thus, Bangladesh Bank data shows that more than 60% of the SME credit disbursed accrued to trade and other service activities while the share of manufacturing was less than 40%. Efforts need to be made, therefore, to enhance flow of credit to manufacturing SMEs.

vii. Human resource development

To address the problem of skilled manpower for SMEs the system of technical and vocational education in the country needs to be revamped. In line with successful international experiences, the government should provide compulsory, state funded education up to the age of fourteen and partially state-funded, compulsory higher secondary education up to the age of 18 or 19. The majority of students will undergo vocational education from the age of fifteen, and most of them will then join one skilled trade or another, although even among the vocational students some may go on to university education in a subject of their choice. Many of the skilled workers may join family-owned SMEs. The institutional capacity to impart appropriate technical and vocational education needs to be strengthened. For this, close association of the potential employers in developing the right curriculum would be important. India's Industrial Training Institutes, which are managed by Institute Management Committees (IMCs) comprising of local industry representatives, could be an example in this regard.

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