

SECTOR ASSESSMENT (SUMMARY): FINANCE (SMALL AND MEDIUM-SIZED ENTERPRISE FINANCE AND LEASING)

Sector Road Map

1. Sector Performance, Problems, and Opportunities

1. **Overview.** The small and medium-sized enterprise (SME) industry in Bangladesh is a key driver of the national economy in Bangladesh. It is estimated that the 7.2 million SMEs in 2013 accounted for 90% of private enterprises, and if micro enterprises are included, the combined segment (7.9 million firms) accounted for 99% of private sector enterprises. The SME industry employs 70%–80% of the nonagricultural workforce. In 2014, SMEs contributed 25% of Bangladesh's gross domestic product (GDP) and 40% of the manufacturing output.¹

2. **Manufacturing.** Comprising primarily micro, small, and medium-sized enterprises (MSMEs), and with a growth rate of 9%, manufacturing was the main contributor to Bangladesh's economy in 2014. According to a survey conducted by the Bangladesh Bureau of Statistics in 2012, the country had 42,792 active manufacturing units in 2012, out of which 40.6% were micro enterprises, 36.6% were small enterprises, and 14.3% were medium-sized enterprises based on the criteria of total number of employees under the national MSME definition.² SMEs accounted for 21,769 manufacturing units (50.9% of the total) in 2012, but MSMEs for 39,153 units (91.5%).

3. **Limited involvement of women.** According to the 2012 survey, 72.4% of SME employees engaged in manufacturing were male workers, and only 27.6% were female workers. Even if micro enterprises are included, the gender composition does not change substantially—74.0% male and 26.0% female. The number of women employed in SME manufacturing is clearly limited. Data on other business segments are not publicly available.

4. **Centralization.** Although comprehensive SME statistics are not available in Bangladesh, the economic census in 2013 provided the geographical spread of enterprises. Among 8.1 million enterprises active in Bangladesh, 5.8 million were located in rural areas and 2.3 million operated in urban areas in 2013. By district, 32.2% of total active enterprises operated in the capital city of Dhaka, followed by the second-largest city of Chittagong (17.1%), Rajshahi (15.1%), Rangpur (13.5%), Khulna (12.8%), Barisal (4.8%), and Sylhet (4.5%). Since the majority of enterprises are SMEs, it is estimated that half of SME operations are concentrated in urban areas.

5. **Credit market.** The SME credit market—as a combined figure of banks and nonbank financial institutions (NBFIs)—has been sharply expanding since 2011. The total SME loans disbursed by banks and NBFIs expanded by 18.3% from Tk853,233 million (\$10.91 billion) in 2013 to Tk1,009,000 million (\$12.97 billion) in 2014. Credit to small firms was marginally higher

¹ This summary is based on the Asia SME Finance Monitor 2014 of the Asian Development Bank (available on request in draft form).

² The Bangladesh Industrial Policy 2010 provides the unified national definition of small and medium-sized enterprises (SMEs), which is based on the value of fixed assets (excluding land and building) and/or the number of employees. Bangladesh Bank, the country's central bank, applies this definition to its SME lending policies (Circular No. 1 of 2011). Firms with fixed assets not exceeding Tk300 million (\$3,857 million) and 250 employees are considered micro, small, and medium-sized enterprises (MSMEs) in manufacturing, while firms with fixed assets not exceeding Tk150 million (\$1,929 million) and 100 employees are considered MSMEs in services and trade. Separately, manufacturing, service, and trade firms with fixed assets of less than Tk0.5 million (\$6,000) and 10 or fewer employees (including family members) are regarded as cottage enterprises.

than that to medium-sized firms. Small firms received 52.1% of total SME loans disbursed in 2014 (Tk525,846 million or \$6.76 billion) while medium-sized firms received 47.9% (Tk483,256 million or \$6.21 billion). The banking industry in Bangladesh continues to be the largest provider of credit to SMEs. Bank lending to SMEs amounted to Tk980,330 million (\$12.60 billion), 97.1% of the total SME loans in 2014. The remaining 2.9% was made by NBFIs.

6. **Geographical disparity.** As for the regional distribution of SME loans, the bulk of the loans by banks and NBFIs went to the urban area in 2014 (74.8% of total SME loans). The most active SME segment in lending by banks and NBFIs was wholesale and retail trade (62.2% of total SME loans), followed by manufacturing (30.0%), and services (7.8%).

7. **Limited access to formal finance.** Limited access to finance is a top obstacle to SME survival and growth in any country. Similar to other countries, the three main problems for SMEs in Bangladesh are (i) a high lending rate, (ii) strict collateral and guarantee requirements for loans, and (iii) complicated loan application procedures. Financial institutions generally regard SMEs as a risky segment for lending, prompting them to impose high interest rates on SME borrowers to cover high transaction costs, and demand collateral and guarantees to mitigate credit risks. The screening process is long because of the extensive documentation required.

8. Accordingly, the following hurdles for SME access to finance exist in Bangladesh:

- (i) **Limited access to formal credit for manufacturers.** Roughly 80% of SME credit goes to the wholesale and retail trade, but only about 10% goes to manufacturing, even though manufacturing is a main driver of the Bangladesh economy and 50% of SMEs (and about 90% of MSMEs) belong to this segment. Financing SME manufacturers, including export-oriented enterprises, needs to be strengthened.
- (ii) **Limited financial outreach to enterprises led by women.** The cumulative disbursement of SME loans during the first quarter of 2015 (from 1 January to 31 March 2015) amounted to Tk252,533 million (\$3,247 million) for men-led SMEs (including cottage industries and micro enterprises)—or 96.6% of total SME loans disbursed. SMSs led by women received only Tk8,867 million (\$114,000), or 3.4% of the total. Their access to formal credit remains difficult.
- (iii) **Limited financial outreach to rural enterprises.** As of the end of 2014, 74.8% of SME loans were provided to urban enterprises, and only 25.2% to rural ones. SME credit is concentrated in the urban area, especially the capital city, Dhaka.

2. Government's Sector Strategy

9. **The government's National Strategy for Accelerated Poverty Reduction II.** The Government of Bangladesh has adopted several reforms and programs to develop small businesses and entrepreneurs. Its National Strategy for Accelerated Poverty Reduction II recognizes the private sector as the engine of economic growth. The promotion of pro-poor growth propelled by the private sector is to be supported by macroeconomic and sector policies, including SME development. To achieve high growth rates, the emphasis is on investments in infrastructure and a knowledge economy—with a focus on rural and nonurban development.

10. **Industrial Policy 2010.** In 2010, the Ministry of Industry issued a new industrial policy covering the (i) roles of the ministry and other relevant agencies—e.g., Bangladesh Small and Cottage Industries Corporation (BSCIC), Board of Investments, and Bangladesh Export Processing Zone Authority—in promoting the development of industries, particularly those with

strong growth potential; (ii) promotion of exports and foreign direct investment; (iii) privatization of state-owned enterprises; and (iv) thrust sectors (such as agro-based industries, handicrafts, and ready-made garments) and underdeveloped areas. The Industrial Policy 2010 emphasizes that SME development will be an integral component of the government's industrialization strategy. To bring dynamism to the SME segment, in terms of new entrants and growth of established enterprises, the Industrial Policy states that a comprehensive approach to SME development will be pursued, i.e., increasing investment in SMEs and removing barriers to their growth through legislative and regulatory reforms. Reforms entail fiscal incentives, access to finance, provision of land and site services, as well as technological and marketing support such as e-commerce and stronger supply-chain management to foster subcontracting and links between SMEs and larger enterprises.

3. ADB Sector Experience and Assistance Program

11. **ADB support for small and medium-sized enterprise development.** The Asian Development Bank (ADB) has provided continued support to the SME segment in Bangladesh through a variety of targeted interventions and through various efforts to broaden and develop the capital markets. The first Capital Markets Development Program³ and its recently concluded successor program⁴ dealt with structural deficiencies in the capital markets and contributed to their stabilization and sustainable development. Encouraged by the success of these two interventions, ADB is now processing a third program scheduled for ADB Board consideration in the second half of 2015. ADB is also providing support for infrastructure development that will enhance SME competitiveness and provide the basis for higher growth rates. Physical infrastructure development is critical for meeting SMEs' needs for power, transport, water, and sanitation. The government recognizes the importance of improving and expanding physical infrastructure, particularly in nonmetropolitan areas, for sustaining economic and social development. It is keen to enhance the private sector's role in providing infrastructure services through public-private partnerships (PPPs). In 2008, ADB provided a \$165 million Public-Private Infrastructure Development Facility (PPIDF1)⁵ and approved in 2012 its successor, PPIDF2,⁶ to promote PPPs in infrastructure finance and catalyze infrastructure debt financing through the Infrastructure Development Company.

12. **ADB-led interventions.** Since the early 1970s, the government and ADB have conducted extensive policy dialogue and provided various support programs for SME development.⁷ A recent example of ADB's support in this area is the SME Sector Development Program (SMESDP),⁸ a two-tranche program loan to create a policy and regulatory framework

³ ADB. 1997. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of Bangladesh for the Capital Market Development Program*. Manila.

⁴ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Policy-Based Loans and Administration of Technical Assistance Grant to the People's Republic of Bangladesh for the Second Capital Market Development Program*. Manila.

⁵ ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Technical Assistance Grant for the Public-Private Infrastructure Development Facility in the People's Republic of Bangladesh*. Manila.

⁶ ADB. 2012. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Technical Assistance Grant for the Second Public-Private Infrastructure Development Facility in the People's Republic of Bangladesh*. Manila.

⁷ Since 1973, ADB has approved 10 major projects, 17 technical assistance projects, and 1 equity investment in the area of SME development. These enabled ADB to gain an in-depth understanding of Bangladesh's SME segment and laid the foundation for the intervention proposed now.

⁸ ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Technical Assistance Grant for the Small and Medium Enterprise Sector Development Program in the People's Republic of Bangladesh*. Manila.

conducive for SME development. The project was deemed successful, with both tranches fully utilized.

13. **Program achievements.** The SMESDP achieved its outcome effectively by laying a strong foundation for promoting SMEs in Bangladesh. It helped establish a policy strategy and appropriate institutions (SME Foundation, BSCIC, and Bangladesh Standards and Testing Institution [BSTI]), a web portal and a virtual window within the Ministry of Industry for SME use, and a well-spread network of helpline outreach centers. Access to finance was also provided by a vast network of about 50 banks (including the four nationalized commercial banks) and another 30 NBFIs with branches and SME booths and centers in regional areas. The banks and NBFIs were supportive of the SME segment since it provided them with the best prospects for growth and profitability.

14. **Small and medium-sized enterprise development project.** Following the success of the SMESDP, ADB's Board approved in 2009 a \$76 million equivalent loan from ADB's Special Funds to implement the SME Development Project (SMEDP1)⁹ aimed at accelerating the development of SMEs, especially in rural and nonurban areas, by improving their access to medium- and long-term credit, with an emphasis on women-led SMEs.

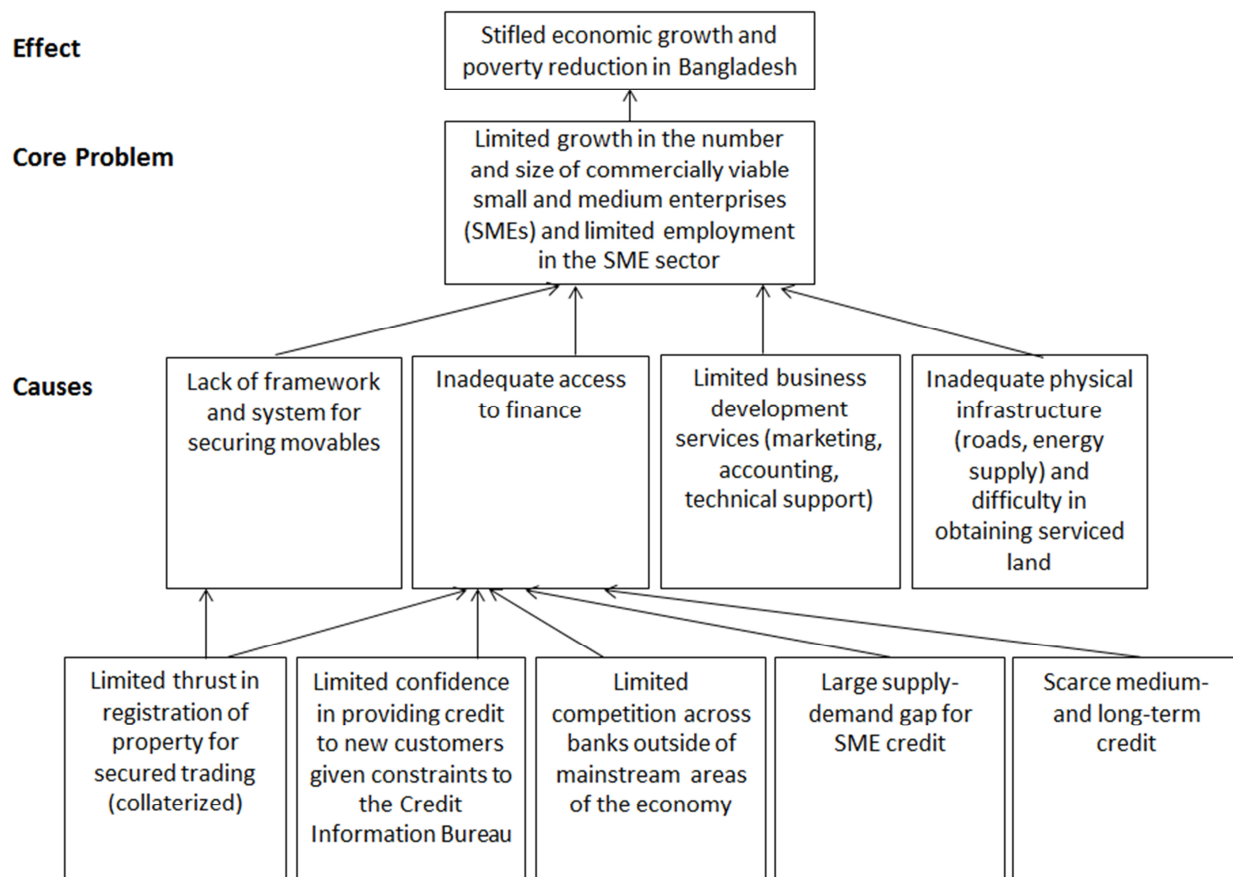
15. **Project achievements.** The demand for SME financing in Bangladesh is large, as evidenced by the fact that the SMEDP1 credit assistance loan of \$76 million was fully disbursed by December 2013, the end of its utilization period. Initial findings from the draft project completion report indicate that the total disbursements made under the project were achieved in line with the original projected cost of \$126.67 million.¹⁰ A total of 37 banks and NBFIs participated in SMEDP1 and provided subloans to 13,645 SMEs, of which 6,589 were new companies. Of the subloans, 12,448 had a tenor of 2–3 years, while 1,197 enterprises received financing with a maturity of 3 years and more. By business segment, 49% of the total credit-line volume was disbursed to trading, 33% to manufacturing, and 18% to services. The subloan repayment performance for the credit line was excellent, as participating financial institutions reported a very high subloan repayment rate by subborrowers (almost all of which were small enterprises). Bangladesh Bank reported no issues relating to compliance with the environmental management system framework under the credit line.

⁹ ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People's Republic of Bangladesh for the Small and Medium-Sized Enterprise Development Project*. Manila.

¹⁰ Pricing of the subloans was risk-based.

PROBLEM TREE

Second Small and Medium-Sized Enterprise Development Project



SECTOR RESULTS FRAMEWORK
Finance Sector Development, 2015–2019)

Country Sector Outcomes		Country Sector Outputs		ADB Sector Operations	
Outcomes with ADB Contribution	Indicators with Targets and Baselines	Outputs with ADB Contribution	Indicators with Incremental Targets	Planned and Ongoing ADB Interventions	Main Outputs Expected from ADB Interventions
SMEs have better access to medium- and long-term credit on a sustainable basis	<p>Increased share of SMEs in gross GDP Baseline: 25% (2014) Target: 30% (2019)</p> <p>Increased share of SMEs in manufacturing output Baseline: 40% (2014) Target: 45% (2019)</p> <p>Increased share of new businesses that are registered by women Baseline: 3.9% (2014) Target: 10% (2019)</p>	<p>Medium- and long-term financing to SMEs</p> <p>Improved access to finance by women entrepreneurs and women-led SMEs</p> <p>Improved financial sector outreach with a focus on women entrepreneurs</p>	<p>SME lending increased by \$333.3 million by 2019</p> <p>Number of women entrepreneur borrowers under SMEDP2 increases from 6.4% (under SMEDP1) to 15% (under SMEDP2)</p> <p>More women are participating in BB's training (baseline to be collected as part of the GAP)</p>	<p>Planned key activity areas</p> <p>Reforms to support capital market development—strengthen capital market policy, improve market governance, strengthen regulatory enforcement, and infrastructure financing through the bond market</p> <p>Pipeline projects with estimated amounts</p> <p>Third Capital Market Development Program (\$150 million)</p> <p>Disaster Risk Financing (\$1.5 million)</p> <p>Ongoing projects with approved amounts</p> <p>Loan to BRAC Bank Sustainable Projects—PSOD (\$30 million)</p>	<p>Planned target subsectors</p> <p>A better-governed, well-developed, transparent and efficient capital market</p> <p>Government bond market developed and providing impetus for corporate bond development</p> <p>Availability of alternative source of financing for PPP projects</p> <p>Pipeline projects</p> <p>Better-governed and stable capital and bond markets</p> <p>Availability of an alternative source of financing (catastrophe bonds)</p> <p>Ongoing projects</p> <p>BRAC Bank's lending program for sustainable projects increases to \$46 million in 2018 (2014 baseline: \$16 million)</p>

ADB = Asian Development Bank, BB = Bangladesh Bank, GAP = gender action plan, GDP = gross domestic product, PPP = public–private partnership, PSOD = Private Sector Operations Department, SMEs = small and medium-sized enterprises, SMEDP1 = Small and Medium Enterprise Development Project, SMEDP2 = Second Small and Medium Enterprise Development Project.

Source: Asian Development Bank.