Report and Recommendation of the President to the Board of Directors

Project Number: 36200
August 2009

Proposed Loan
People’s Republic of Bangladesh: Small and Medium-Sized Enterprise Development Project

Asian Development Bank
CURRENCY EQUIVALENTS
(as of 25 August 2009)

Currency Unit – taka (Tk)

Tk1.00 = $0.0144812
$1.00 = Tk69.05500

ABBREVIATIONS

ACSPD – Agricultural Credit and Special Programs Department
ADB – Asian Development Bank
BSCIC – Bangladesh Small and Cottage Industries Corporation
BWCCI – Bangladesh Women Chamber of Commerce and Industry
CRAB – Credit Rating Agency of Bangladesh Limited
CRISL – Credit Rating Information and Services Limited
DFID – Department for International Development of the United Kingdom
EA – executing agency
EMS – environmental management system
GDP – gross domestic product
IA – implementing agency
ICT – information and communication technology
IFC – International Finance Corporation
MFI – microfinance institution
MOF – Ministry of Finance
MOF-FD – Finance Division of the Ministry of Finance
MOI – Ministry of Industries
NBFI – nonbank financial institution
NGO – nongovernment organization
NSPR – National Strategy for Accelerated Poverty Reduction
PFI – participating financial institution
SDR – special drawing rights
SEDF – SouthAsia Enterprise Development Facility
SMEs – small and medium-sized enterprises
SMESDP – SME Sector Development Program
TA – technical assistance

NOTES

(i) The fiscal year (FY) of the Government of Bangladesh ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2000 ends on 30 June 2000.

(ii) In this report, "$" refers to US dollars.
<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
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<td>Operations 1</td>
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<td>South Asia Department (SARD)</td>
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<td>Director</td>
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# CONTENTS

<table>
<thead>
<tr>
<th>Contents</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>LOAN AND PROJECT SUMMARY</strong></td>
<td>i</td>
</tr>
<tr>
<td><strong>I. THE PROPOSAL</strong></td>
<td>1</td>
</tr>
<tr>
<td><strong>II. RATIONALE: SECTOR PERFORMANCE, PROBLEMS, AND OPPORTUNITIES</strong></td>
<td>1</td>
</tr>
<tr>
<td>A. Performance Indicators and Analysis</td>
<td>1</td>
</tr>
<tr>
<td>B. Analysis of Key Problems and Opportunities</td>
<td>4</td>
</tr>
<tr>
<td><strong>III. THE PROPOSED PROJECT</strong></td>
<td>14</td>
</tr>
<tr>
<td>A. Impact and Outcome</td>
<td>14</td>
</tr>
<tr>
<td>B. Outputs</td>
<td>14</td>
</tr>
<tr>
<td>C. Special Features</td>
<td>14</td>
</tr>
<tr>
<td>D. Project Investment Plan</td>
<td>15</td>
</tr>
<tr>
<td>E. Financing Plan</td>
<td>16</td>
</tr>
<tr>
<td>F. Implementation Arrangements</td>
<td>16</td>
</tr>
<tr>
<td><strong>IV. TECHNICAL ASSISTANCE</strong></td>
<td>19</td>
</tr>
<tr>
<td><strong>V. PROJECT BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS</strong></td>
<td>20</td>
</tr>
<tr>
<td>A. Benefits and Impacts</td>
<td>20</td>
</tr>
<tr>
<td>B. Risks</td>
<td>20</td>
</tr>
<tr>
<td><strong>VI. ASSURANCES AND CONDITIONS</strong></td>
<td>21</td>
</tr>
<tr>
<td>A. Specific Assurances</td>
<td>21</td>
</tr>
<tr>
<td>B. Condition for Loan Effectiveness</td>
<td>22</td>
</tr>
<tr>
<td><strong>VII. RECOMMENDATION</strong></td>
<td>22</td>
</tr>
</tbody>
</table>

**APPENDIXES**

1. Design and Monitoring Framework                                       23
2. Small and Medium-Sized Enterprise Sector Analysis                     25
3. External Coordination Matrix                                           32
4. Environmental Management System Framework                             34
5. Eligibility Criteria for Participating Financial Institutions, Subborrowers, and Subprojects  40
6. Due Diligence Summary of Pre-Identified Participating Financial Institutions  42
7. Technical Assistance Subproject for Promoting Women’s Entrepreneurship  48
8. Funds Flow Chart                                                       50
9. Implementation Schedule and Arrangements                              51
10. Summary of Poverty Reduction and Social Strategy                      52
11. Gender Action Plan                                                    55
12. Financial Management Assessment                                       57
13. Governance and Anticorruption Risk Assessment                         62

**SUPPLEMENTARY APPENDIXES (available on request)**

A. Detailed SME Sector Analysis                                           63
B. Pre-Identified Participating Financial Institutions Due Diligence      63
C. Governance and Anticorruption Risk Assessment                          63
D. Completed Financial Management Assessment Questionnaires              63
E. Prohibited Investment Activities List                                  63
F. Technical Assistance Subproject for Promoting Women’s Entrepreneurship 63
G. Bangladesh Bank Corporate Governance Guidelines                        63
LOAN AND PROJECT SUMMARY

Borrower
People’s Republic of Bangladesh

Classification
Targeting classification: General intervention
Sector (subsectors): Industry and trade (small and medium-sized enterprise development)
Themes (subthemes): Economic growth (promoting economic efficiency and enabling business environment), private sector development (private sector investment), gender equity (gender equity in [economic] opportunities)
Location impact: rural (high impact) and national (high impact)

Environment Assessment
Category FI. An environmental management system framework was prepared (Appendix 4).

Project Description
The Small and Medium-Sized Enterprise Development Project is aimed at accelerating the development of small and medium-sized enterprises (SMEs), especially SMEs in rural and nonurban areas, by improving their access to medium- and long-term credit.

Rationale
The major development challenge in Bangladesh is a sharp east–west regional divide in terms of employment and economic growth. The contrast in the incidence of poverty between the eastern and western parts of the country is significant—with a headcount ratio of 32%–34% in the eastern part (comprising Dhaka, Chittagong, and Sylhet divisions) versus 47%–52% in the western part (comprising Barisal, Khulna, and Rajshahi divisions). This disparity has emerged as a key public policy concern. Unemployment and underemployment in the western part are also much higher than in the eastern part. The Government’s policy priority is to foster economic development in nonmetropolitan and/or rural and nonurban areas (i.e., outside the metropolitan areas of Dhaka and Chittagong) to address regional inequalities.

The Government’s development agenda for nonmetropolitan and/or rural and nonurban areas recognizes the private sector as the engine for growth and employment. Nonmetropolitan SMEs comprise 60%–65% of the country’s 1.5 million SMEs and account for most of the private sector in rural and nonurban areas. Nonmetropolitan SMEs are a key driver to reduce poverty in the country since these SMEs are responsible for generating rural nonfarm activities—the source of more than 50% of employment and income for the rural population.

An investment climate assessment conducted by the World Bank in October 2008 indicates that access to credit (particularly medium- to long-term credit) remains a key constraint for SMEs. Lack of credit access is more marked in nonmetropolitan areas. As a result, nonmetropolitan SMEs are unable to realize their full potential to grow and generate employment.
There are indications that the global financial crisis is beginning to impact the economy. The recession in developed markets and the economic slowdown in the Middle East are beginning to threaten Bangladeshi exports and remittances which can have a significant impact on unemployment in the economy. In the context of the projected economic slowdown from the global financial crisis, the Government has sought Asian Development Bank (ADB) support for a key stimulus measure—enhanced access to finance to enable SMEs to operate at full potential.

Impact and Outcome

The impact of the proposed Project will be contribution to continuing economic growth and poverty reduction through development and growth of the SME sector. A vibrant SME sector is critical for investment, growth, and employment creation in the context of the projected economic slowdown. The Project’s specific and immediate expected outcome will be enhanced growth in the number and size of commercially viable SMEs, especially SMEs in rural and nonurban areas with emphasis on women-led SMEs, as well as increased employment in the SME sector.

Component

The Project comprises a credit facility for enhancing access to medium- to long-term financing through participating financial institutions (PFIs) to eligible SMEs located outside the metropolitan areas of Dhaka and Chittagong.

Project Investment Plan

The Project’s estimated investment cost is $126.67 million equivalent, with ADB contributing 60%.

Financing Plan

<table>
<thead>
<tr>
<th>Source</th>
<th>Total</th>
<th>%</th>
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<tbody>
<tr>
<td>ADB</td>
<td>76.00</td>
<td></td>
</tr>
<tr>
<td>Government (Bangladesh Bank)</td>
<td>19.00</td>
<td>75.00</td>
</tr>
<tr>
<td>PFIs</td>
<td>19.00</td>
<td>15.00</td>
</tr>
<tr>
<td>SMEs</td>
<td>12.67</td>
<td>10.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>126.67</strong></td>
<td><strong>100.00</strong></td>
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Financing will include a loan of SDR48,927,000 ($76 million equivalent) from ADB’s Special Funds resources, with a 32-year term, including a grace period of 8 years, and an interest charge of 1% per annum during the grace period and 1.5% per annum thereafter. It will include such other terms and conditions as may be set forth in the draft loan and project agreements.

Allocation and Relending Terms

The Finance Division of the Ministry of Finance will make the ADB loan available to Bangladesh Bank. Bangladesh Bank will reblend...
to PFIIs in local currency at the Bangladesh Bank rate. The Government will bear the foreign exchange risk. PFIIs will onlend the funds to eligible SMEs outside Dhaka and Chittagong metropolitan areas. The PFIIs will onlend at interest rates reflecting their costs of funds plus a spread that covers transaction costs and risk-adjusted returns. Since the Project’s credit facility is aimed at improving access to credit by SMEs, it is deemed appropriate to make the ADB loan available to as wide a number of eligible financial institutions as possible. The PFI loans are to be disbursed over 3 years, subject to a midterm review after 18 months to evaluate disbursement progress. Another review will be undertaken at the end of 3 years.

**Period of Utilization**

30 March 2013

**Estimated Project Completion Date**

30 September 2012

**Executing Agency**

Finance Division of the Ministry of Finance

**Implementation Arrangements**

The implementing agency will be Bangladesh Bank. The Project’s credit facility will be administered by the well-qualified and experienced professionals in Bangladesh Bank’s Agricultural Credit and Special Programs Department that have effectively managed the credit assistance loan under ADB’s ongoing SME Sector Development Program.

**Procurement**

Procurement under ADB-financed subloans will be in accordance with ADB’s *Procurement Guidelines* (2007, as amended from time to time), as these relate to financial intermediary loans. Eligible subborrowers will be required to undertake procurement in accordance with established private sector or commercial practices that are acceptable to ADB.

**Project Benefits and Beneficiaries**

There are significant benefits in pursuing private-sector-led regional SME development. The Project’s main benefits are (i) an SME-driven increase in rural and nonurban employment and output; (ii) enhanced business opportunities for SMEs and PFIIs through improved access to credit; (iii) catalyzing the enhanced capabilities of PFIIs and their SME credit staff in SME financing operations as well as in risk mitigation, project appraisal, supervision, credit, and portfolio administration for small loans; (iv) expanded SME portfolios of PFIIs; (v) enhanced empowerment of women entrepreneurs by ensuring access to enterprise finance; and (vi) improved operational governance of PFIIs as well as transaction-based accountability for corporate governance and anti-money laundering through the Project’s eligibility criteria for disbursements to PFIIs. Since the development partners, except ADB and the World Bank, are engaged solely in technical assistance (TA) grant support for SMEs in Bangladesh, the Project will yield synergistic effects for SME development in
Bangladesh by complementing and supporting the development partners’ extensive TA activities (nationwide TA coverage and encompassing all SME subsectors). From 2009 to 2012, the Project is expected to generate an 8% increase in SME sector employment as well as an 8% increase in the number of SMEs established throughout the country—primarily in rural and nonurban areas. Employment generation through the Project will help reduce the relatively high incidence of poverty outside the metropolitan areas of Dhaka and Chittagong.

**Risks and Assumptions**

Achieving the expected benefits and impacts depends on several assumptions that are subject to varying degrees of risks. Mitigation measures are being put in place where feasible.

**SME viability.** The creditworthiness of SMEs in some locations could affect utilization of the Project’s credit facility. ADB’s assessment indicates that PFIs have significant opportunities for lending to viable SMEs outside the metropolitan areas of Dhaka and Chittagong. To enhance SME viability, the Government has provided greater tax incentives for SMEs located outside the metropolitan areas than those located in metropolitan areas.

**Delinquency.** Delinquency risks that PFIs face in expanding their SME portfolios outside the metropolitan areas of Dhaka and Chittagong are mitigated through (i) improved access to credit information; (ii) risk-based pricing; (iii) Bangladesh Bank monitoring; and (iv) setting up dedicated SME units staffed with capable personnel, efficient systems, and proper procedures.

**Private sector perception.** Private investors’ perceptions are critical for the flow of investment in SMEs outside the metropolitan areas of Dhaka and Chittagong. Measures under the Project to sustain investor confidence include PFIs’ commitments up front to provide credit to viable SMEs. For its part, the Government has given priority to reducing regional inequalities by facilitating public infrastructure development, particularly in nonmetropolitan areas. The enabling environment for SMEs is also being enhanced.

**Implementation.** While the demand for SME credit is robust, there could still be implementation delays in case the eligible PFIs refocus their priorities and/or fail to sustain expected performance standards. These risks have been dealt with by assessing PFI eligibility and commitment up front. In addition, the Project enables removal of PFIs in case of performance shortcomings.

**Technical Assistance**

To enhance the sustainability of the Project, a TA subproject grant support amounting to $500,000 has been approved through regional TA 6337 (Development Partnership Program for South Asia), funded under the Australia–ADB South Asia Development Partnership Facility, to be administered by ADB. The impact of the TA subproject will be the development of women’s micro, small,
and medium-sized entrepreneurship in the project area. The outcome will be the enhanced capacity of women entrepreneurs and associations to fully access the financial resources and services earmarked for women-led SMEs under the Project. More specifically, the TA subproject will (i) help assess constraints and opportunities to women entrepreneurs’ effective access to financial resources made available under the loan; (ii) support the financial and legal literacy of women entrepreneurs and associations; (iii) enhance women entrepreneurs’ capacity, productivity, and competitiveness; (iv) promote networking among women entrepreneurs’ associations; and (v) develop a sex-disaggregated database for monitoring and evaluation of the social and gender equality results. The TA subproject will be implemented in selected districts identified at project onset based on a set of agreed criteria, outside the metropolitan areas of Dhaka and Chittagong. The TA subproject outcomes will be monitored by the Finance Division of the Ministry of Finance and ADB through consultants’ reports, periodic consultations and review missions.

An ongoing TA to support ADB’s SME Sector Development Program in Bangladesh has been extended till June 2010. The scope of the targeted SME capacity building component under this TA is being enlarged to enhance capacity of PFI s to undertake financial analysis of SMEs, particularly in rural and nonurban areas.
I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed loan to the People’s Republic of Bangladesh for the Small and Medium-Sized Enterprise Development Project.

II. RATIONALE: SECTOR PERFORMANCE, PROBLEMS, AND OPPORTUNITIES

A. Performance Indicators and Analysis

2. **Macroeconomic context.** Bangladesh’s economy has exhibited resilience in the face of the global economic downturn. Despite the global recession, especially in countries to which it exports both goods and migrant workers, Bangladesh maintained gross domestic product (GDP) growth of 5.5% in FY2009. Per capita income is $690 in FY2009—up from $608 in FY2008. However, there are indications that the global financial crisis is beginning to affect the economy. The recession in developed markets and the economic slowdown in the Middle East are beginning to threaten Bangladesh exports and remittances.

   (i) **Exports.** Overall export growth has been volatile and slowed considerably to a monthly decline of 4.6% by March 2009. Exports of ready-made garments, while still growing, have fallen significantly from 59% at the beginning of FY2009 to 19% in February 2009. Ready-made garment export orders have declined since December 2008, and this will have a lagged impact on exports. Prices of ready-made garment exports are being renegotiated downward in some cases, while in others, buyers are requesting an extension of shipment dates. The performance of the ready-made garment sector is crucial because it accounts for over three-quarters of export earnings and contributes about 12% of GDP. It also accounts for about 40% of manufacturing output and employment, and supports many ancillary industries. The global economic downturn is also exerting significant downward pressure on both the demand and price of a number of Bangladesh’s other exports—such as jute, leather, pharmaceutical exports, and frozen food items. World Bank calculations, based on the latest census surveys on the quarterly real GDP growth outlook, suggest that Bangladesh’s export markets will contract in 2009.

   (ii) **Remittances.** Remittances have been a key driver of economic growth and poverty reduction in Bangladesh, so the impact of the global financial crisis on remittances is of critical importance. Remittances have held up so far but growth rates are declining rapidly. Monthly remittance growth slowed from 44.7% in July 2008 to 7.6% in April 2009—the lowest so far this fiscal year. The bulk of Bangladesh’s remittances (about 63%) come from the Middle East, which hosts over 3.6 million Bangladeshi workers. The lackluster performance of many Gulf Cooperation Council countries is adversely affecting work opportunities for migrants from Bangladesh, and therefore future remittances. Meanwhile, there are reports of visas to workers being cancelled and some migrants returning to Bangladesh.

   (iii) **Job losses.** The current labor force is estimated at around 50 million. There could be a significant impact on unemployment in an economy where 2 million people enter the labor force every year if the export industries continue to lay off workers. In the immediate future, the domestic economy may need to create about 2.0 million–2.5 million new jobs to keep unemployment under control. While the impact of the global financial crisis on employment in the ready-made garment sector (3.1 million employed) is expected, the textile and jute sectors have already started to suffer. In the textile sector, 12 out of 341 spinning mills are reported to have shut down and most of the mills have reduced their operation by about 30%. Reduction in yarn
export has led most of the jute enterprises to reduce production levels by 25%–30% and to lay off 10,000–20,000 workers during July–December 2008. According to the Bangladesh Jute Spinners Association, job losses in the jute sector may reach 50,000 by the end of FY2009.

(iv) **Government response in the context of the global financial crisis.** In March 2009, the Government formed a 27-member financial crisis task force headed by the finance minister and comprising the country’s foremost economists, top bureaucrats, and representatives from the private sector, civil society, and political parties. The task force is mandated to monitor impacts of the global financial crisis and recommend stimulus measures to address the crisis by focusing on growth-promoting activities that include support to small and medium-sized enterprises (SMEs). To enhance liquidity and stimulate lending, the central bank—Bangladesh Bank—cut the repo and reverse repo rate by 25 basis points in March 2009. The lending limits of the four state-owned commercial banks were also doubled (from 5% to 10%) in March 2009 to boost domestic investment. State-owned commercial banks’ capacity to provide loans to a single borrower was also raised. In April 2009, the Government announced a stimulus package for Tk50 billion to boost business confidence, shore up social safety nets, and support key sectors of the economy. A more comprehensive stimulus package was announced in the FY2010 budget, with specific budget allocation to address these challenges.

3. **Development challenge.** Although Bangladesh has a small land area and a relatively homogeneous population, economic development has not advanced at the same rate in all the regions of the country. Sharp east–west regional differences in the incidence of poverty and per capita income are a major development challenge, which may be exacerbated by the global financial crisis. The contrast in the incidence of poverty between the eastern and western parts of the country is significant—with a headcount ratio of 32%–34% in the eastern part (comprising Dhaka, Chittagong, and Sylhet divisions) and 47%–52% in the western part (comprising Barisal, Khulna, and Rajshahi divisions). This regional disparity has recently emerged as a key public policy concern. The incidence of poverty at the national level was estimated at 40% in 2005. Estimates based on the household income and expenditure survey 2000 and 2005 also indicate that the average real per capita income in the metropolitan areas of Dhaka and Chittagong is about 40% higher than in other metropolitan areas.

4. **Development paradigm.** Expanded roles for foreign direct investment and public–private partnerships are critical elements of the Government’s development agenda. The narrowing fiscal space is prompting growing reliance on the private sector for investments and service delivery. The Government is cognizant that a well-functioning SME sector could take the lead in generating jobs and economic growth while raising income levels for a large segment of the population. The majority of firms outside of metropolitan areas are SMEs. Rural nonfarm activities—the most promising force behind poverty reduction in the country, and the source of more than half of employment and incomes for the rural population—are fully reliant on those small enterprises. However, these enterprises have not realized their full potential for contributing to economic growth.

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1 Bangladesh consists of six divisions—Dhaka, Chittagong, Sylhet, Barisal, Khulna, and Rajshahi. Each division consists of numerous districts. For instance, Dhaka Division has seventeen districts (including Dhaka District) and Chittagong Division has eleven districts (including Chittagong District).


3 Dhaka metropolitan area is defined as the Dhaka city corporation (population of about 6.7 million) and represents only part of Dhaka District. Chittagong metropolitan area is defined as the Chittagong city corporation (population of about 3.0 million) and represents only part of Chittagong District. The urban section of Bangladesh comprises six city corporations (Dhaka, Chittagong, Sylhet, Barisal, Khulna, and Rajshahi), which are collectively referred to as “metropolitan areas” in this report. “Nonmetropolitan areas” comprise peri-urban areas around each of the six city corporations; these are also known as *sadder upazilas* (small towns and villages).
and employment generation. The Government recognizes the importance of SMEs in equitable regional growth. Accordingly, regional SME development is one of the key elements of the Government’s strategy for reducing regional inequalities in its latest national development strategy, *Moving Ahead: National Strategy for Accelerated Poverty Reduction II (FY2009–2011).*

5. **Small and medium-sized enterprises.** There are nearly 1.5 million SMEs in Bangladesh, 60%–65% of which are located outside the metropolitan areas of Dhaka and Chittagong. There is a very high density of SMEs in the industrial economy of Bangladesh. SMEs constitute over 99% of private industrial establishments and provide job opportunities to about 70%–80% of the nonagricultural labor force. The SME share in manufacturing value added to GDP varies at 28%–30%. The services sector is primarily composed of SMEs, which is responsible for the bulk of employment growth. SME contribution to national exports is significant through different industries such as ready-made garments, jute, and leather (Appendix 2). SMEs are broadly segregated as follows:

   (i) Small informal enterprises typically employ 5-9 persons and are largely family-based. Having grown from microenterprises, they use significant portions of their business revenues to invest in expansion. Typically, these enterprises lack access to formal credit and support services.

   (ii) Small formal sector enterprises typically employ 10–50 persons and have well-established relationships with larger manufacturing and trading concerns. While significant growth potential exists, they face leadership and management challenges. Sources of finance are usually retained earnings and supplier credits.

   (iii) Medium-sized enterprises typically employ 51–150 persons and serve as a link between the formal and informal economies through well-established supplier and buyer relationships with small formal and informal SMEs, as well as with large domestic and international corporate entities. Although professionally managed, there is a need to maintain competitiveness. Access to finance remains constrained even for this category of SMEs.

6. The vision and strategies for SME development in Bangladesh explicitly address the concerns of entrepreneurs in the SME sector within the national economic and social framework as set out in National Strategy for Accelerated Poverty Reduction II of the Planning Commission. Furthermore, in its final draft form, the Industrial Policy 2009 of the Ministry of Industries (MOI) clearly states that SME development will be one of the cornerstones of the Government’s industrialization strategy. MOI facilitates measures to promote development, growth, and international competitiveness in the SME sector as an integral part of the national economy. All policy and programming initiatives for the SME sector are designed to be consistent with and complementary to the existing policy initiatives of other key ministries.

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5 SMEs are defined as those enterprises employing up to 150 staff. Small enterprises can employ up to 50 people and medium-sized enterprises can employ 51–150 people. A lower limit for small enterprises is not defined by Bangladesh Bank circular but can be assumed to be five staff based on numerous SME statistical surveys conducted by development partners and the Government. In terms of the total value of assets, the definition classifies (i) small enterprises as those with fixed asset value (excluding land and buildings) of Tk0.05 million–Tk15 million; and (ii) medium-sized enterprises as those with fixed asset value (excluding land and buildings) of Tk15 million–Tk200 million. Source: Bangladesh Bank. 2008. *Agriculture Credit and Special Programs Department Circular No. 8.* Dhaka (26 May).


7 Typically employ up to four persons, mostly from the same family. Activities include handicrafts, shops, trade, and services, and often at the premises of the owners.
B. Analysis of Key Problems and Opportunities

1. Analysis of Key Problems

7. An investment climate assessment\(^8\) indicates that scarcity of certain resources (energy, finance, land, and labor skills) has started to put a strain on Bangladesh’s further growth and productivity gains, as factor markets have not risen up to the challenge of efficiently reallocating resources to the highest productivity entities within the economy. Because of inefficient reallocation of resources, especially restricted access to finance to the productive and poverty-reducing SME sector, the Bangladesh economy curtails its own productivity growth, income growth, and poverty reduction. The majority of firms in nonmetropolitan areas of Bangladesh are SMEs. These are a key driver to reduce poverty in the country since they are responsible for generating rural nonfarm activities—the source of more than 50% of employment and income for the rural population.

a. Access to Finance

8. Limited access to formal credit remains the strongest constraint on SMEs’ growth prospects in terms of a large supply–demand gap and scarce medium- and long-term credit.

(i) **Large supply–demand gap for small and medium-sized enterprise credit.** The overall supply–demand gap for SME credit is estimated at Tk165 billion. The total demand for SME lending is estimated at Tk255 billion\(^9\) while current supply for SME credit (based on current SME loan principal outstanding) is estimated at Tk88.8 billion (Appendix 2). The supply–demand gap for SME credit is more pronounced for nonmetropolitan SMEs than metropolitan SMEs, which indicates that SME lending is concentrated in metropolitan areas—limiting the potential of rural and nonurban development. An estimated 50.8% of metropolitan firms had at least one loan from a financial institution. While 75% of nonmetropolitan firms report a need for financing, only 6% availed of formal finance. In 2006-2008, 3% had borrowed from banks and 3% from nongovernment organizations (NGOs) and microfinance institutions (MFIs). Access to formal finance for larger nonmetropolitan enterprises (employing 10 or more workers) is comparable to that of smaller metropolitan firms, with 32% reporting having a bank loan and 3% with NGO and MFI loans. Start-up SMEs find it even harder to borrow from banks\(^10\) and even SMEs that have access are able to borrow much less than their investment needs. As a result, firms need to use internal savings to finance investment; internal sources fund 70% of firm investment in Bangladesh, as opposed to lower shares in other South Asian countries. Overall, the SME credit situation for women entrepreneurs is more acute.

(ii) **Scarce medium- and long-term credit.** Because of the relatively small equity market and nascent long-term debt market, financial institutions like banks are unable to mobilize adequate medium- and long-term funding domestically. Commercial banks in Bangladesh are facing maturity mismatches in their asset and liability management as they rely on short-term deposits as their financial source. With the absence of a sovereign rating, Bangladesh has limited access to international financial markets. Medium- and long-term credit is scarcer for nonmetropolitan enterprises than for metropolitan enterprises. In metropolitan areas, 69% of lending has a maturity of less than 3 years. A little less than half of the loans have maturities of 1 year. In nonmetropolitan areas, the average loan term for bank

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World Bank.

\(^10\) Only 14% of working capital for small firms in Bangladesh is financed by bank loans compared with 30% for medium-sized firms. Only 11% of new SME investment in Bangladesh is financed through bank loans.
loans was 17 months, and 75% of loans had a maturity of 1 year. More than a third (38%) of nonmetropolitan enterprises reported having access to supplier credit, but this is also very short-term finance—with 80% of firms reporting repayment periods of 3 weeks or less. As a result, medium- to long-term financing is typically procured through accumulated earnings, and this leads to underinvestment and lower employment and production growth for SMEs, especially nonmetropolitan SMEs.

b. Enabling Environment

9. While the Government has successfully taken measures for enhancing the operating environment for SMEs, some weaknesses still need to be addressed. These include the following:

(i) **Inadequate and unreliable credit information.** The available information and track record of a potential SME borrower is limited, as credit rating agencies and credit information bureaus do not cover their operations. A credit information bureau is operated by the central bank (Bangladesh Bank) containing current loan information for all borrowers of financial institutions regulated by Bangladesh Bank. The system is not computerized. It contains information about current loans above Tk50,000 (not the full banking history of the borrower) and does not have a unique identifier for borrowers. This reduces the effectiveness of the system, particularly affecting smaller firms that cannot build up reputation-based credit. The resulting information asymmetry prevents banks from reasonably assessing SMEs’ creditworthiness.

(ii) **Lack of a framework and system for securing movables.** SME entrepreneurs typically have little land to offer by way of collateral, but they have movable property ranging from equipment to inventory to receivables. However, the absence of a legal and regulatory framework to allow financial institutions to secure their lending against such security is a constraint. Linked to this is the lack of a central registry to ensure the integrity of such collaterals.

c. Connectivity to Markets

10. The majority of nonmetropolitan enterprises in Bangladesh sell their goods and services directly to consumers located within the same union and/or ward where they are located, which largely limits the size of the markets for their products and services. Connectivity to markets, in terms of market linkages as well as technological and information exchange, is vital for the growth of peri-urban, small town, and village areas. Low demand is perceived as the most serious obstacle to doing business in nonmetropolitan areas, linked significantly to low access to larger markets. Very few firms have ready access to any business services such as marketing, accounting, or technical support. As a result, SMEs, particularly in the nonmetropolitan areas, are disadvantaged in terms of market-related know-how and capacity for market research as well as vocational training required for improved product quality. These enterprises face difficulties in upgrading technology and locating buyers for their products in larger markets.

d. Physical Infrastructure Constraint

11. The quality of and access to infrastructure play an important role in the establishment, operation, and expansion of an enterprise. In addition to limited access to finance, Bangladeshi firms have identified (i) inadequate and poor quality infrastructure (roads and energy supply), and (ii) difficulty in obtaining land (especially serviced land), as the primary hindrances for private sector competitiveness (footnote 8). These hindrances are more severe for nonmetropolitan firms compared with metropolitan firms. Serviced land is the single defining (or limiting) factor of new or expanding entrepreneurs. Smaller firms are cut off more severely from access to land.
e. **Disadvantaged Women Entrepreneurs**

12. Women entrepreneurs are less educated and have significantly less access to SME finance. The rates of women entrepreneurship are lower among rural nonfarm enterprises compared with metropolitan firms. Nonmetropolitan enterprises owned by women are smaller, younger, and more likely to be informal and home-based. Only 2% of these firms are registered, compared with 42% for firms owned by men.

2. **Analysis of Opportunities**

13. Regional economic disparity is of enormous economic and political significance in Bangladesh (para. 3). With the availability of medium- to long-term funds, there arises considerable interest among financial institutions in exploring SME financing opportunities beyond the metropolitan areas of Dhaka and Chittagong. This makes a business case for financial institutions to diversify and expand their portfolios in rural and nonurban areas outside the metropolitan areas of Dhaka and Chittagong. As critical as access to finance is, however, its development impact depends on reform measures—both financial and nonfinancial.

a. **Enhancing the Enabling Environment**

14. **Credit information.** The Government is facilitating the automation of the credit information bureau at Bangladesh Bank to ensure the availability of credit history for all SMEs through a 16-month grant project funded by the Department for International Development (DFID) of the United Kingdom and managed by the International Finance Corporation’s (IFC’s) SouthAsia Enterprise Development Facility (SEDF). The project commenced in May 2009 and will be completed by September 2010. Furthermore, Dun & Bradstreet, a provider of business information for risk management decisions, will commence operations in Bangladesh by December 2009 with the specific task of assigning credit ratings to SMEs. These efforts will enable coverage of all SME borrowers and will help the banks to shift from purely collateral-based lending to cash-flow-based lending that emphasizes greater reliance on character, better understanding of the business, and credit rating information at the outset of the credit relationship with SMEs.\(^{11}\) Credit information will also facilitate adoption of credit scoring methods by lenders to reduce appraisal time and cost.

15. **Securing moveables.** The Government is pursuing enactment of a secured transactions bill to increase the availability of secured financing alternatives by enabling SMEs to use their movable property as collateral. Earlier Asian Development Bank (ADB) technical assistance (TA) supported this effort.\(^{12}\) The Ministry of Justice is vetting the final draft of the secured transactions bill and enactment is expected by December 2009.

b. **Improving Connectivity to Markets**

16. Better market activity would strengthen technological, financial, and information exchange between larger and smaller companies, as well as urban and rural ones. The Government provides business support and capacity development assistance as well as infrastructure facilities to SMEs, mainly through the Bangladesh Small and Cottage Industries Corporation (BSCIC). Founded in 1957 by legislation as the principal government organization mandated to promote the development of countrywide small and cottage industries, BSCIC is responsible for (i) allotment of

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\(^{11}\) Support for cash-flow-based lending does not mean the elimination of collateral. The basis for credit in cash-flow-based lending is not the collateral offered by the borrower but rather the borrower’s ability to repay the loan (i.e., SMEs can obtain credit on the strength of their creditworthiness). Less restrictive covenants can be utilized, such as pari passu treatment for all creditors or the guarantee of the owners instead of requiring hard collateral. Having such a system in place could serve as an incentive for SMEs in the informal sector to move to the formal sector.

developed industrial estates in 64 districts in Bangladesh; (ii) entrepreneurship training programs conducted by its training arm, Small and Cottage Industries Training Institute; (iii) credit arrangement and end-use supervision; (iv) design, development, and distribution of prototypes through its design center; (v) research and development activities; (vi) management and skills development; and (vii) market study and marketing assistance (e.g., trade fairs). To move BSCIC toward a leaner and more effective organization, the Government has initiated a number of restructuring measures\(^{13}\) for BSCIC on policy, governance, strategic development, management structure, and a staffing plan based on recommendations under ADB’s ongoing SME Sector Development Program (SMESDP).\(^{14}\) Furthermore, the product certification system of Bangladesh Standard Testing Institute was upgraded with the installation of modern equipment in 2008, which will promote product certification among SMEs and facilitate access to export markets.\(^{15}\)

17. Under ADB’s ongoing SMESDP, an SME web portal has been designed and developed at MOI’s SME cell, which (i) disseminates information about SMEs in Bangladesh such that any local or foreign buyer or investor can easily reach the SMEs and initiate any business relationship; (ii) facilitates e-governance and provides online information for SMEs on government facilities and services, such as requirements for business registration, licensing, and product certification; and (iii) contains a library of SME-related information, such as a list of business development services providers and a link to the SME database. Furthermore, the SMESDP supported the establishment and operationalization of SME helpline outreach centers at district offices of BSCIC and facilities of the Dhaka and Chittagong chambers of commerce and industry to provide advisory support to facilitate SME access to government services, including registration and licensing. The outreach centers will be linked to the SME web portal to facilitate their services to SMEs. IFC also provides a comprehensive business development services website for Bangladesh to provide a one-stop shop for local SMEs and service providers to access business resources, training, and information. One of the largest projects in the field of SME promotion in Bangladesh is KATALYST (Developing Business Service Markets),\(^{16}\) which is funded by DFID, Swiss Development Corporation, Netherlands Development Organisation, and Canadian International Development Agency. The assistance of KATALYST aims to improve market access, management and technical skills, quality, and production methods. KATALYST identifies key constraints and opportunities in sectors (such as manufacturing, agriculture, and services) and promotes mechanisms that improve business performance. Other development partners are also significantly involved in improving connectivity to markets (paras. 32–33).

**c. Enhancing Physical Infrastructure**

18. 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. The development of essential infrastructure\(^{17}\) to generate pro-poor growth is one of the key elements under the Government’s National Strategy for Accelerated Poverty Reduction II. The Government is keen to enhance the private sector’s role in providing infrastructure services through public–private partnerships. ADB provided a $165 million Public–

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\(^{13}\) Based on recommendations made by the BSCIC restructuring committee constituted by MOI, a road map to BSCIC strategic reorientation was prepared and submitted to ADB by MOI in May 2008. The road map is currently being implemented.


\(^{15}\) Financed by ADB TA under the SMESDP (footnote 14).

\(^{16}\) KATALYST is in phase 2 (a 5-year phase that started in March 2008).

\(^{17}\) Development partners, including ADB, provide continuing support for infrastructure development. ADB’s projects include construction of roads and transport infrastructure, development of the power and gas sector, and improvement in the efficiency of Chittagong Port.
Private Infrastructure Development Facility 18 to promote public–private partnerships in infrastructure finance and catalyze infrastructure debt financing through the Infrastructure Development Company Limited. This facility complements the World Bank’s $50 million Investment Promotion and Finance Facility Project 19 that supports private sector participation and provides long-term finance for infrastructure projects. The Government is also seeking to leverage its own resources by fostering innovative ways to involve private partnerships in the financing, development, management, and servicing of economic zones in nonmetropolitan areas through the World Bank’s $150 million Private Sector Development Support Project. 20 Economic zones address key competitiveness issues facing firms (including SMEs) by providing serviced land, reliable infrastructure, adequate logistics, and an authority that attends to the needs of the zone’s tenants.

d. Financial Sector Reforms

19. Ongoing financial sector reforms focus on (i) greater autonomy for Bangladesh Bank, (ii) strengthening Bangladesh Bank’s capabilities to perform its enhanced responsibilities, (iii) strengthening prudential regulations and supervision, 21 (iv) restructuring the management and internal processes of state-owned commercial banks and ultimately privatization, (v) strengthening the legal and judicial processes, 22 and (vi) improving the money and debt markets. These reforms have been supported by the World Bank, the International Monetary Fund, and ADB.

20. The World Bank’s Financial Institutions Development Project 23 has enhanced the government debt market from a market with limited maturities and literally no secondary trading to an active market with regular auctions for debt with maturities up to 10 years. In addition, simplification of market regulations to facilitate bond and security issues and rules and procedures for bonds and debentures were also developed and implemented. The World Bank is also strengthening the capacity of Bangladesh Bank 24and is reforming some nationalized commercial banks, leading to their privatization, under the Enterprise Growth and Bank Modernization Project 25 and the Second Development Support Credit Project. 26 Progress on key reforms has been integrated in the International Monetary Fund’s Poverty Reduction Growth Facility.

21. The ADB-financed Capital Market Development Program 27 helped enhance the market capacity and develop a fair, transparent, and efficient domestic capital market to attract investment capital for augmenting the capital resources of the banking system and improve efficiency in

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21 Including (i) an increase in the minimum risk-weighted capital adequacy requirements for banks from 8% to 9% and in the minimum capital requirements from Tk400 million to Tk1 billion; (ii) tightening of loan classification, rescheduling, and provisioning rules; (iii) introduction of loan write-off guidelines; (iv) creation of an early warning system; (v) issuance of risk management guidelines in the areas of credit, foreign exchange, asset–liability management, internal control, and anti-money laundering; and (vi) introduction of measures to improve corporate governance.
22 The Money Loan Court Act’s reform to allow creditors to sell collateral without a trial is a significant step forward. However, the major bottleneck lies in cumbersome enforcement procedures to sell collateral through public auctions. Allowing for private, licensed enforcement and auction agents would significantly speed recovery of collateral.
24 World Bank. 2003. Central Bank Strengthening Project. Washington, DC. This supports implementation of Bangladesh Bank’s strengthening program by providing assistance in three major areas—legal framework, reorganization and modernization, and capacity building.
allocating resources. More recently, an ADB TA loan is supporting governance and capacity development of the capital market as well as the insurance sector. Through ADB’s Good Governance Program, ADB is enhancing investor confidence in the capital market as well as increasing the nation’s competitiveness and attractiveness for foreign direct investments by mitigating widespread corruption.

22. While significant reforms and reform initiatives are under way, market gaps remain. The impact of the ongoing reforms in the financial sector—to address structural issues such as capital market development and availability to the private sector of alternative sources of medium- to long-term funds—will only be realized during the medium to long term. As a result, the significant gap in SME financing will persist in the short term. Addressing the prevailing market inadequacies while keeping the SME development agenda moving forward are important for Bangladesh.

3. Government Policy Support for SME Development

23. The Government’s 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 sector development. To achieve high growth rates, emphasis is on investments in infrastructure and a knowledge economy—with a focus on rural and nonurban development. In its final draft form, MOI’s new Industrial Policy, 2009, covers (i) the roles of MOI and other relevant agencies including BSCIC, the 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 2009 in its final draft form emphasizes that SME development will be an integral component of the Government’s industrialization strategy. To bring dynamism to the SME sector, in terms of new entrants and growth of established enterprises, the Industrial Policy states that a comprehensive approach to SME development will be pursued that emphasizes increasing investment in the SME sector and removing barriers to its 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 improving supply chain management to foster subcontracting and linkages between SMEs and larger enterprises.

24. The visions and strategies for SME promotion under the Industrial Policy and National Strategy for Accelerated Poverty Reduction II were derived from the Government’s SME policy and development framework. Drawing on work of the National Task Force on Development of SMEs

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28 ADB. 2006. Report and Recommendation of the President to the Board of Directors: Proposed Loan for the Improvement of Capital Market and Insurance Governance Project in the People’s Republic of Bangladesh. Manila. Part 1 will enhance the governance and capacity of the capital market and target the regulator, stock exchanges, market practitioners, and investors. It reflects a continuing effort by ADB to help develop the domestic market, which will be critical if resources are to be mobilized to support private sector activity and promote economic growth. Part 2 will enhance the governance and capacity of the insurance sector, as it will support government-led reforms being pursued in the insurance sector. These twin efforts are being undertaken in parallel with a reform program supported by the International Monetary Fund and the World Bank aimed at strengthening Bangladesh’s banking sector.

29 ADB. 2007. Report and Recommendation of the President to the Board of Directors: Proposed Loan and Technical Assistance Grant for the Good Governance Program in the People’s Republic of Bangladesh. Manila. As a prelude to this project, ADB provided TA through (i) ADB. 2003. Technical Assistance: Supporting Good Governance Initiatives in the People’s Republic of Bangladesh. Manila; and (ii) ADB. 2005. Technical Assistance: Supporting Good Governance Initiatives II in the People’s Republic of Bangladesh. Manila. The aim of these TA projects was to promote medium- to long-term development of collective anticorruption efforts at various institutions and to enhance the capacity of the Anticorruption Commission.
in 2005 the Government formulated an SME policy and development framework in consultation with various stakeholders including SMEs and development partners. MOI’s SME cell issued Policy Strategies for Development of SMES—a policy and development framework that (i) provides justification for government assistance to the sector; (ii) maps out a government development strategy to support the SME sector over the short, medium, and long term; (iii) identifies areas of assistance to SMEs to enhance their access to capital, business support services, and technology to improve their product marketability and competitiveness; (iv) delineates the institutional setup to take responsibility for SME sector development; and (v) incorporates internationally accepted market-based principles for SME development.

25. To promote SME development in the nonmetropolitan areas, SMEs established in nonmetropolitan areas are entitled to tax incentives (such as a minimum 75% income tax rebate and accelerated depreciation rates for plant and machinery) for a longer period than SMEs established in metropolitan areas with effect from FY2006. The 2008–2009 budget also promotes SME development through special tax incentives. Specifically, SMEs with annual turnover of less than Tk.2.4 million are now tax exempt. Furthermore, the minimum individual income tax level was raised to Tk165,000 for the male taxpayer and Tk180,000 for the female taxpayer from the existing Tk150,000 level. Raising the minimum individual income tax level acts as an incentive to SMEs.

4. ADB Support for Small and Medium-Sized Enterprise Development

26. ADB has provided sustained support for the SME sector in Bangladesh through efforts to broaden financial markets (paras. 19–22) and SME-focused interventions. Such long-term structural issues as developing the capital market and availability to the private sector of alternative sources of medium- to long-term funds are being addressed through ADB support. ADB is also providing support for infrastructure development involving ports, highways, and roads that will enhance SME competitiveness and provide the basis for a higher growth rate (para. 18).

27. The two-tranche program loan component under ADB’s ongoing SMESDP (footnote 14) is deemed successful as both tranches were released. The SMESDP created a conducive policy and regulatory framework to facilitate SME development. Specifically, the program loan achieved

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30 The SME task force was established by the Government on 5 November 2003 to prioritize specific elements of SME policies from the perspective of Bangladesh. The SME task force—comprising 16 members from the Government, academia, and the private sector—was chaired by the principal secretary of the Prime Minister’s Office.


32 Provision of tax incentives was a condition for second tranche release under ADB’s ongoing SMESDP (footnote 14). The second tranche was released in July 2008.


34 The first tranche was released in December 2005 after all 10 conditions were assessed as fully complied with. The second tranche was released in July 2008 after 10 conditions were assessed as fully complied with, two conditions were assessed as substantially complied with, and one condition required a waiver.
the following three outcomes:  

First, the establishment of an SME policy and development framework to provide impetus and guidance for development of the sector (para. 24). Second, the establishment of an institutional structure and necessary mechanisms to support SME development. The Government created the SME Foundation with support from ADB’s SMESDP in November 2006 as an independent apex body for SMEs under the Companies Act, 1994, to have at least 50% private sector representation on the board and a chief executive officer recruited from the private sector. The SME Foundation will assume the responsibilities for implementing the SME development strategy including (i) policy advocacy and intervention for SME growth, (ii) establishment of a comprehensive SME database, (iii) human resource development and capacity building based on training needs assessment, (iv) facilitating application of new technology for SME growth, (v) administering and supporting SME access to finance, and (vi) conducting productivity and quality improvement programs. The Government is in the process of hiring a full-time chief executive officer for the SME Foundation, and strengthening of the institutional capacity of foundation is ongoing through training, exposure to international best practices, on-the-job learning, and organizational development.

28. The third outcome of the program loan defined government support to SMEs and facilitated SME access to various services. This entailed (i) rationalization of government assistance to the SME sector through BSCIC restructuring (para. 16); (ii) provision of SME tax incentives (para. 25); (iii) enhancement of SME access to market, government services, capacity development, and product certification, including upgrading of the current product certification system to international standard (paras. 16–17); and (iv) development of an integrated SME database for improved targeting of assistance. Within item (iii), targeted SME capacity development (for rural nonfarm enterprises, women’s enterprises, and participating financial institutions (PFIs)) to improve SME performance and competitiveness commenced in September 2008 and is expected to be completed by June 2010. The scope of the targeted SME capacity building component is being enlarged to enhance capacity of PFIs to undertake financial analysis of SMEs, particularly in rural and non-urban areas. For item (iv), the development of an integrated SME database by MOI and Bangladesh Bureau of Statistics should be completed by June 2010. Once completed, the database will serve as the basis for monitoring SME performance and development as well as for targeting assistance. The proposed Bangladesh Public Expenditure Support Facility (a firm 2009 loan) supports the Government’s SME efforts of promoting women entrepreneurship, issuing credit provision guidelines on the basis of risk-based assessment, and establishing SME centers nationwide. The facility also supports the Government’s endeavor to establish a financial institution from the merger of Bangladesh Shilpa Bank and Bangladesh Shilpa Rin Shangstha to provide enhanced financing for the private sector, including for SME development.

29. The $30 million credit assistance loan under ADB’s SMESDP, i.e., the Small Enterprise Fund, was fully utilized by the end of June 2009—about 12 months ahead of schedule (over the past 3 years, total SME lending volume in the country has significantly expanded at an average annual growth rate of 55%). SMEs in Dhaka and Chittagong districts disproportionately benefited from the credit assistance loan. Out of a total of 64 districts in the country, Dhaka and Chittagong districts utilized 55% of the credit line while 45% of the credit line was utilized by the remaining 62 districts in terms of disbursement volume. Similarly, more than 50% of the enterprises that utilized this credit line were only from Dhaka and Chittagong districts (1,403 enterprises) while 1,396 enterprises were from the remaining 62 districts. In terms of sector distribution, 27% of the total volume of the credit line was disbursed to the manufacturing sector, 57% to the trade sector, and 16% to the services sector. The subloan repayment performance for the credit line was

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35 A TA loan attached to the SMESDP is providing technical advice and resources needed to build capacity and assist in program implementation to achieve the stated outcomes of the program.

36 The European Commission’s €19 million TA grant for Integrated Support to Poverty and Inequality Reduction through Enterprise Development, which is scheduled for approval in September 2009, will be harmonized with ADB’s SMESDP to enhance the institutional capacity of the SME Foundation.
excellent, as PFIs reported a subloan repayment rate of 93%–97% by subborrowers (almost all of which were small enterprises). No issues with regard to PFI compliance with the environmental management system (EMS) framework were reported by Bangladesh Bank under the credit line.

5. Lessons

30. Based on lessons from the SMESDP (para. 29), the Project will stimulate activities in areas outside of the two main metropolitan centers—Dhaka and Chittagong—which will be important for overall economic growth and poverty reduction in Bangladesh. The design of the Project incorporates lessons from a review carried out by the ADB Independent Evaluation Department on the performance of ADB’s financial intermediation loans to development finance institutions that highlighted governance issues including direct lending, weak credit analysis, deficiencies in the monitoring of projects, and pricing mismatches. Critical remedial measures proposed by the Independent Evaluation Department were as follows: (i) appropriate selection of effective private sector banks and selective use of performance-oriented state-owned banks are crucial to efficient delivery of SME subloans, and (ii) autonomy in lending and pricing decisions since market-based onlending rates are more effective than subsidized credit.

31. The design of the Project also incorporates important recommendations put forth by a special evaluation study update on financial intermediation support by the ADB Independent Evaluation Department and a best-practice note on SME support by the ADB Regional and Sustainable Development Department. Both studies emphasize that the following three-pronged program where the elements are mutually complementary needs to be adopted to build a strong foundation for efficient and effective SME financial intermediation: (i) creating a conducive policy and regulatory framework to ease constraints on SME finance and private sector development; (ii) developing a broad-based, competitive, and efficient financial sector to provide entrepreneurs with alternative sources of investment capital, a diversified selection of new and innovative products, competitive rates, and efficient services to make their investments viable; and (iii) promoting SME support services such as skills, trades, entrepreneurship, and other business development services. In line with the key recommendations of both evaluation studies, the efficiency and effectiveness of the proposed Project’s credit facility will be facilitated by (i) a conducive SME policy and regulatory framework that has been created under the SMESDP (paras. 27–28); (ii) broad-based and significant financial sector reforms under way (paras. 19–22); and (iii) the promotion of SME support services by the Government, ADB, and other development partners (paras. 16–17, 28, 32–33).

6. Development Partner Coordination

32. Since the development partners (except ADB and the World Bank) are engaged solely in TA grant support for SMEs in Bangladesh, the proposed Project’s credit facility complements the development partners’ extensive TA activities (i.e., nationwide TA coverage and encompassing all SME subsectors), which will yield synergistic effects for SME development in Bangladesh. Specifically, several development partner TA activities will directly ensure enhanced access to finance of the Project’s credit facility by SMEs. One of IFC-SEDF’s components under the ongoing phase 2 of its SME development activities includes an access to finance program that supports PFIs through a combination of TA and policy-related work, particularly enhancing PFIs’ capacity for SME financing with regard to financing product development, risk management practices, and knowledge dissemination. A component under the European Commission’s upcoming €19 million

40 The World Bank also contributed $10 million from its Enterprise Growth and Bank Modernization Project to the Small Enterprise Fund in ADB’s ongoing SMESDP.
TA grant for Integrated Support to Poverty and Inequality Reduction through Enterprise Development in September 2009 will introduce sustainable improvements in SME access to appropriate and affordable finance. Specific measures include (i) capacity development of Bangladesh Bank Training Academy through collaboration with the European Bank Training Association to train bank regulators on how to improve the regulatory framework that supports enhancing SME access to appropriate and affordable finance; and (ii) capacity development of the Bangladesh Institute of Bank Management through collaboration with the European Bank Training Association to train the management and staff of commercial banks on all aspects of SME banking, including financial product development suitable to SME needs and cash-flow-based lending.

33. After successful completion of phase 1 in December 2008, IFC-SEDF commenced phase 2 of its SME development activities in January 2009 (phase 2 is a $36 million TA grant to be concluded in June 2014), which builds on phase 1 and includes (i) an access to finance program (para. 32); (ii) a sector development and business services program that facilitates the development of firms providing business development products and services; and (iii) a business enabling environment program that promotes trade, enhances gender development, and develops conducive policy and regulatory frameworks. The World Bank and DFID are collaborating in the Private Sector Development Support Project (para. 18) to make infrastructure investments in economic zones (including SMEs). In March 2007, the Private Sector Development Support Project supported the creation of a TA fund—the Bangladesh Investment Climate Fund—a separate entity managed by IFC. The activities of the IFC Bangladesh Investment Climate Fund provide considerable synergy to the Private Sector Development Support Project by providing advisory assistance to ensure a sustainable, long-term impact of economic zone infrastructure investments through improvements in the regulatory framework. The Japan International Cooperation Agency undertakes SME activities in Bangladesh through its Private Sector Development Program, which includes SME studies (specifically silk, jute, and software industries) on potential industry growth for export diversification. The United States Agency for International Development commenced a $11 million 5-year TA grant for Poverty Reduction by Increasing the Competitiveness of Enterprises in February 2008 to alleviate constraints hindering the competitiveness of selected SME subsectors. An external coordination matrix is in Appendix 3.

7. ADB Support in the Context of the Global Financial Crisis

34. The SME sector is critical for investment, growth, and employment creation in the context of the projected economic slowdown (para. 2) from the global financial crisis since SMEs account for about 25% of GDP and more than 75% of employment in Bangladesh. A dynamic SME sector is also needed to reduce regional differences (para. 3) by accelerating growth for employment and private sector development, especially in the rural and nonurban (i.e., nonmetropolitan) areas. The contribution of SMEs to economic growth depends on financial and nonfinancial inputs for stimulating start-up SMEs and growth of established SMEs. Government initiatives (paras. 23–25) and ADB’s interventions for SME development, as well as the ongoing financial reforms (paras. 19–22) and infrastructure investments (para. 18), provide the opportunity for accelerating SME development. However, inadequate mobilization of medium- to long-term resources by the domestic market and the SME financing pattern skewed in favor of the metropolitan areas of Dhaka and Chittagong (para. 29) have resulted in a large demand–supply gap, especially for rural and nonurban (i.e., nonmetropolitan) SMEs. Nonmetropolitan SMEs have bankable demand for credit, so access to adequate medium- to long-term credit is important for enabling them to benefit from economic opportunities by adopting new technologies and business processes. This is important for increasing and diversifying sources of income in the rural and nonurban (i.e., nonmetropolitan) areas. Accordingly, support for SMEs, particularly SMEs in the nonurban and rural areas, is integral to the economic growth strategy of the Government.

41 The European Bank Training Association is a well-established network of national banking training institutes across the European Union.
35. In the context of the financial crisis, enhanced access to finance to enable SMEs to operate at full potential is a key stimulus measure for which the Government has sought ADB support (Section D of Appendix 2 analyzes the financial crisis impact on SME activities and SME credit demand in Bangladesh). The Project is therefore a credit line and a follow-on to ADB’s ongoing SMESDP (footnote 14). The credit line for $30 million under the ongoing SMESDP was fully utilized by June 2009, about 12 months ahead of schedule. Accordingly, and consistent with ADB’s country operations business plan 2009–2011 for Bangladesh, the Project provides a credit facility to PFIs for onlending to SMEs, particularly SMEs located in the rural and nonurban areas. This will fill a critical market gap and catalyze the establishment and development of rural and nonurban (i.e., nonmetropolitan) SMEs. The Project builds on lessons in SME development (paras. 30–31) and is firmly anchored to the market, with risk-based pricing consistent with Basel II requirements.

III. THE PROPOSED PROJECT

A. Impact and Outcome

36. The impact of the Project will be contribution to continuing economic growth and poverty reduction through development and growth of the SME sector. A vibrant SME sector is critical for investment, growth, and employment creation in the context of the projected economic slowdown. The Project’s specific and immediate expected outcome will be enhanced growth in the number and size of commercially viable SMEs, especially SMEs in rural and nonurban areas with emphasis on women-led SMEs, as well as increased employment in the SME sector. The design and monitoring framework is in Appendix 1.

B. Outputs

37. Credit facility. The Project comprises a credit facility for expansion of medium- to long-term financing by PFIs to SMEs located outside the metropolitan areas of Dhaka and Chittagong, with emphasis on women-led SMEs. This will include institutionalizing social and environmental safeguards in SME operations and credit provision by financial institutions. The eligibility criteria for PFIs, subborrowers, and subprojects are elaborated in Appendix 5.

38. Enhanced capacity of women entrepreneurs and associations through TA support. To enhance the sustainability of the Project, TA grant support (paras. 61–62, Appendix 7, and Supplementary Appendix F) will be provided to enhance the capacity of women entrepreneurs and associations to fully access the financial resources earmarked for women-led SMEs under the Project.

C. Special Features

39. The Government’s equitable regional development priority allows ADB the opportunity to support a high-priority inclusive development intervention. The request for ADB support recognizes its involvement with the financial sector, SMEs, microfinance, and private sector development.

40. Rural and nonurban development. The Project provides critical support for minimizing the urban–rural divide by systematically providing business and employment opportunities for populations outside the metropolitan areas of Dhaka and Chittagong (i.e., the populations with the highest poverty incidence) to participate in, and benefit from, economic growth. Broader sharing of the benefits of growth will reinforce the sustainability of the development process. Furthermore, since Dhaka and Chittagong represent the highest level of clustering in the country, congestion costs outweigh the benefits of agglomeration. Consequently, other cities and peri-urban and rural

areas offer many advantages in terms of availability of cheaper land and labor, and little or less congestion. Expansion of nonfarm activities in those areas is therefore desirable from the point of view of balanced regional development and poverty reduction. This is also consistent with government and ADB strategies for supporting growth in rural and nonurban areas.

41. **Enhancing private sector role.** The Project enhances private sector-led SME development for economic growth and employment by mainstreaming SME lending in the financial system instead of just defining one or a few PFIs. Currently, some financial institutions that are keen to engage in SME lending are constrained by limited availability of term funds at reasonable cost while others need to be provided with incentives to expand their loan portfolio. The expansion of term funds at reasonable rates through the Project will induce financial institutions to focus on the SME sector and trigger the expansion of their SME portfolio. Furthermore, the efforts of development partners (paras. 32–33) to build the capacity of PFIs for SME lending will be leveraged through the Project’s credit facility.

42. **Empowerment of women entrepreneurs.** To ensure women’s access to the opportunities and benefits provided under the loan, a gender action plan has been prepared (Appendix 11) to present modalities for addressing gender concerns under the Project and its associated TA (Appendix 7). A portion of the Project’s credit line facility will be earmarked to target qualified women entrepreneurs and ensure their access to enterprise finance. The associated TA will contribute to enhance women entrepreneurs’ capacity to access and optimally utilize the financial resources and services earmarked for them under the Project.

43. **Key stimulus measure to address financial crisis impact on economy.** In the context of the projected economic slowdown from the global financial crisis and the likely significant impact on unemployment in the economy, the Project is a key stimulus measure that enhances access to finance to enable SMEs to operate at full potential thereby generating jobs and economic growth. Section D of Appendix 2 analyzes the financial crisis impact on SME credit demand in Bangladesh.

### D. Project Investment Plan

44. The project investment cost is estimated at $126.67 million equivalent (Table 1). Funding from the Government and ADB will not exceed 75% of subproject costs.

<table>
<thead>
<tr>
<th>Table 1: Project Investment Plan</th>
<th>($) million</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Item</strong></td>
<td><strong>Amount</strong></td>
</tr>
<tr>
<td><strong>A. Base Cost</strong></td>
<td></td>
</tr>
<tr>
<td>1. ADB Project Loan</td>
<td>76.00</td>
</tr>
<tr>
<td>2. Government (Bangladesh Bank) Contribution</td>
<td>19.00</td>
</tr>
<tr>
<td>3. PFI Contribution</td>
<td>19.00</td>
</tr>
<tr>
<td>4. SME Contribution</td>
<td>12.67</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>126.67</strong></td>
</tr>
<tr>
<td><strong>B. Contingencies</strong></td>
<td>0.00</td>
</tr>
<tr>
<td><strong>C. Financing Charges During Implementation</strong></td>
<td>—</td>
</tr>
<tr>
<td><strong>Total (A + B + C)</strong></td>
<td><strong>126.67</strong></td>
</tr>
</tbody>
</table>

**ADB** = Asian Development Bank, **PFI** = participating financial institution, **SMEs** = small and medium-sized enterprises.

*PFI interest charges (based on Bangladesh Bank rate) will be greater than 1% interest charge on the ADF loan.

Source: ADB estimates.
E. Financing Plan

45. The financing plan is shown in Table 2. Subloans from PFIs to SMEs will not exceed 90% of subproject costs.

<table>
<thead>
<tr>
<th>Source</th>
<th>Total</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>ADB</td>
<td>76.00</td>
<td></td>
</tr>
<tr>
<td>Government (Bangladesh Bank)</td>
<td>19.00</td>
<td>75.00</td>
</tr>
<tr>
<td>PFIs</td>
<td>19.00</td>
<td>15.00</td>
</tr>
<tr>
<td>SMEs</td>
<td>12.67</td>
<td>10.00</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>126.67</strong></td>
<td><strong>100.00</strong></td>
</tr>
</tbody>
</table>

Source: ADB estimates.

46. The Government has requested a loan of SDR 48,927,000 ($76.0 million equivalent) from ADB’s Special Funds resources. The loan will have a 32-year term, including a grace period of 8 years, and an interest charge of 1% per annum during the grace period and 1.5% per annum thereafter. It will include such other terms and conditions as may be set forth in the draft loan and project agreements. The financing charges are not to be capitalized. The Government will bear the foreign exchange risk.

47. **Relending (Government through Bangladesh Bank to PFIs).** The ADB loan will be made available to Bangladesh Bank. Bangladesh Bank will relend to PFIs in local currency at the Bangladesh Bank rate\(^{43}\) for a term not exceeding 20 years.

48. **Onlending (PFIs to eligible SMEs).** The maximum subloan size will be Tk7 million, of which PFIs will be able to lend up to 75% of subproject costs from the ADB and Government loan proceeds. The minimum tenor of a subloan will be 2 years. Onlending from PFIs to eligible subprojects will be at interest rates that reflect their cost of funds\(^{44}\) plus a spread to cover transaction costs and risks. Subloans will be on commercial and competitive terms based on the PFI’s selection process. Subloans will only include activities not listed in ADB’s prohibited investment activities list (Supplementary Appendix E) and will be subject to post-lending monitoring and review by ADB. Appendix 8 provides a funds flow illustration for the Project.

F. Implementation Arrangements

1. **Project Management**

49. **Executing Agency and Implementing Agency.** The Executing Agency (EA) for the Project will be the Finance Division of the Ministry of Finance (MOF-FD) and the Implementing Agency (IA) will be Bangladesh Bank. The Agricultural Credit and Special Programs Department of Bangladesh Bank will administer the Project’s credit facility. Appendix 9 provides an organization chart showing implementation arrangements.

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\(^{43}\) The rate at which Bangladesh Bank lends to commercial banks.

\(^{44}\) This currently represents the Bangladesh Bank rate of 5%. Domestic resource mobilization efforts continue to pose a challenge for financial institutions. Nonbanking financial institutions are limited in their scope for accepting deposits while banks face difficulties in mobilizing deposits because of market distortions where above-market returns (11.5%–12.0%) are given to bond investors in the Government’s national saving schemes whereas banks offer deposit rates of 6.5% (savings accounts) to a maximum of 9.5% (fixed deposit accounts).
50. **Bangladesh Bank as facility manager.** Bangladesh Bank was deemed appropriate to administer the Project at this stage because of Bangladesh Bank's large contribution to the Project, its ready access to information in determining the financial soundness and capabilities of PFIs for providing credit to the SME sector, and its function as administrator of the Credit Information Bureau, which gathers information regarding borrowers. No feasible alternative for facility management could be found. Concerns about governance, conflict of interest, and lack of capacity of candidate facility managers earlier considered ruled them out. Bangladesh Bank's regulatory and supervisory capacity is being strengthened under the World Bank's ongoing Central Bank Strengthening Project. Guidance and support are provided in designing new bank regulation policy and strengthening prudential regulations, reporting, and enforcement. Bangladesh Bank has made progress in improving its financial reporting, auditing, and control systems; and has adopted the International Accounting Standards as its accounting basis. Furthermore, the Project will be administered by well-qualified professionals in Bangladesh Bank's Agricultural Credit and Special Programs Department, who have managed the Small Enterprise Fund effectively under ADB's ongoing SMESDP. Bangladesh Bank will regularly monitor (i) PFIs' continued eligibility based on eligibility criteria, and (ii) eligible disbursements against estimated PFI targets to SMEs at market interest rates consistent with ADB's financial intermediary loan policy.45

2. Implementation Period

51. The scheduled implementation period for the Project is 3 years (October 2009 – September 2012). The schedule is in Appendix 9.

3. Procurement

52. Procurement under ADB-financed subloans will be in accordance with ADB's *Procurement Guidelines* (2007, as amended from time to time) as they relate to financial intermediary loans. Eligible subborrowers will be required to undertake procurement in accordance with established private sector or commercial practices that are acceptable to ADB.

4. Anticorruption Policy

53. ADB’s *Anticorruption Policy* (1998, as amended to date) was explained to and discussed with the Government, EA, and IA. Consistent with its commitment to good governance, accountability, and transparency, ADB reserves the right to investigate, directly or through its agents, any alleged corrupt, fraudulent, collusive, or coercive practices relating to the Project. To support these efforts, relevant provisions of ADB’s *Anticorruption Policy* are included in the loan regulations for the Project. In particular, all contracts financed by ADB in connection with the Project shall include provisions specifying the right of ADB to audit and examine the records and accounts of the Executing Agency and all contractors, suppliers, consultants, and other service providers as they relate to the Project. During review missions, the financial management, governance, and anticorruption risk assessments will be updated to ensure their provisions remain valid and are helping to realize the Project’s objectives.

54. The Project seeks to accelerate and deepen good governance in PFIs in accordance with Bangladesh Bank corporate governance standards and Bangladesh’s international obligations by (i) ensuring PFI compliance with Bangladesh Bank’s corporate governance measures as one of the eligibility criteria for disbursements to PFIs; (ii) incorporating anti-money-laundering risk management requirements; (iii) reporting on corporate governance structures and activities in PFI annual reports; (iv) applying SME lending monitoring system; and (v) incorporating good governance and anticorruption measures in loan assurances in accordance with the findings of the governance and anticorruption risk assessment (Appendix 13). The Project also seeks to enhance

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financial management controls through (i) the Bangladesh Bank imprest account; (ii) funds flow controls, including vetting and approval procedures; and (iii) audit and accounting requirements.

5. **Disbursement Arrangements**

55. Bangladesh Bank, as administrator or facility manager of the Project’s credit line, will be responsible for preparing disbursement projections, collecting supporting documents, preparing withdrawal applications, and sending the latter to ADB in accordance with ADB’s *Loan Disbursement Handbook* (2007, as amended from time to time). Bangladesh Bank will (i) provide information to ADB on candidate PFIs, including its assessment of their eligibility for the Project’s credit line; (ii) disqualify any PFI that has become ineligible based on a semiannual review; and (iii) review utilization and repayments of subloans of PFIs. Bangladesh Bank will maintain proper accounts, procedures, and records adequate to monitor and record the progress of subprojects financed by PFIs every 6 months. Bangladesh Bank will review and report to ADB the utilization of the facility through progress reports every 3 months. The terms and conditions of the facility will be amended as necessary based on the outcome of the review in coordination with ADB to increase utilization of the fund and respond to market needs. Bangladesh Bank will also monitor the socioeconomic and environmental benefits of the subprojects.

56. To facilitate the timely release of loan proceeds and to expedite project implementation, the Government will, immediately after the loan becomes effective, open and maintain a project imprest account with Bangladesh Bank that is to be also managed by Bangladesh Bank. The initial advance to the imprest account will be 6 months' worth of estimated expenditures or 10% of the loan amount, whichever is lower. ADB’s statement of expenditures procedure will be used to liquidate advances from the imprest accounts. The maximum individual payment permitted under the statement of expenditures procedure is $200,000 equivalent. Appendix 12 provides the financial management assessment report.

6. **Accounting, Auditing, and Reporting**

57. MOF-FD will keep a record of the utilization of the Project, and will ensure that the record keeping and accounting undertaken by Bangladesh Bank follow accounting and financial management procedures acceptable to ADB. Bangladesh Bank will maintain records and accounts for the Project, which will be audited annually in accordance with sound accounting standards by independent auditors acceptable to ADB. Annual audited reports and financial statements in accordance with auditing standards acceptable to ADB, in English, will be submitted to ADB within 6 months after the end of each fiscal year. The auditor’s opinion of that part of the examination relating to the imprest account and state of expenditure procedure should be separately set out in the auditor’s report.

58. The Project’s monitoring reports prepared by Bangladesh Bank based on inputs from PFIs will be provided quarterly to the EA and ADB. The reports will contain (i) description of progress made during the period; (ii) changes to the implementation schedule, if any; (iii) problems and difficulties encountered and remedial actions taken; (iv) the social, environmental, and economic impacts; (v) the work to be carried out in the next period; and (vi) a summary financial account for the Project with expenditures to date. Within 3 months of the Project's completion, the EA, through Bangladesh Bank, will furnish to ADB a project completion report containing a detailed evaluation of project design, costs, PFI performance, social and economic impacts, and other details as may be requested by ADB.

7. **Project Performance Monitoring and Evaluation**

59. Bangladesh Bank will need to maintain a project performance management system satisfactory to ADB. The key performance indicators and assumptions in the design and monitoring
framework will be the basis for the system. Within 3 months of loan effectiveness, Bangladesh Bank will have established the baseline for each of these indicators, and such information will be made available to review missions and to the Government for future impact assessment surveys. The scope of the survey, quantity and quality of data, and frequency of collection will be guided by the need for feedback on implementation.

8. Project Review

60. To ensure responsive and timely implementation, there will be review missions in accordance with the project implementation schedule set forth in Appendix 9. There will be regular interaction between the EA, Bangladesh Bank, and ADB. Annual performance review will be conducted by the Government, Bangladesh Bank, and ADB. In addition, a comprehensive midterm review will be undertaken by the Government, Bangladesh Bank, and ADB about 18 months after the Project’s effectiveness that will (i) evaluate the scope, design, and implementation arrangements; (ii) assess implementation performance against project indicators; (iii) review and establish compliance with loan covenants; and (iv) identify problems and constraints and, if necessary, recommend changes in the design or implementation arrangements.

IV. TECHNICAL ASSISTANCE

61. To enhance the sustainability of the Project, a TA subproject grant support amounting to $500,000 has been approved through regional TA funded under the Australia–ADB South Asia Development Partnership Facility, to be administered by ADB. The impact of the TA subproject will be the development of women’s micro, small, and medium-sized entrepreneurship in the subproject area. The outcome will be enhanced capacity of women entrepreneurs and associations to fully access the financial resources earmarked for women-led SMEs under the Project. The TA subproject will (i) help assess constraints and opportunities to women entrepreneurs’ effective access to the financial resources made available under the loan; (ii) support the financial and legal literacy of women entrepreneurs and associations; (iii) enhance women entrepreneurs’ capacity, productivity, and competitiveness; (iv) promote networking among women entrepreneurs’ associations; and (v) develop a gender-disaggregated database for monitoring and evaluation of the social and gender equality results. The TA subproject will be implemented in selected districts identified at project onset based on a set of agreed criteria, outside the metropolitan areas of Dhaka and Chittagong.

62. The TA subproject outcomes will be monitored by MOF-FD and ADB through consultants’ reports, periodic consultations and review missions. The Bangladesh Women’s Chamber of Commerce and Industry (BWCCI) will be engaged for the implementation activities under the TA subproject in accordance with ADB’s Guidelines on the Use of Consultants (2007, as amended from time to time). Detailed implementation arrangements will be set out in the TA subproject agreement. The implementation team fielded by BWCCI will comprise national experts, subcontracted training institutes, and NGOs. The scale of consultant inputs, terms of reference, cost estimates, and implementation arrangements are in Supplementary Appendix F. The disbursements under the TA subproject will be made directly by ADB in accordance with its Technical Assistance Disbursement Handbook.48

47 The rationale for the proposed single-source selection of BWCCI is based on the following: (i) BWCCI’s long-term track record and leadership in the area of capacity development targeting women entrepreneurs; (ii) its proven track record of engagement with the Government in supporting gender-responsive policy and legal and regulatory reforms; (iii) its far-reaching and sector-wide coverage compared with other like-minded institutions; (iv) its leadership in the implementation of gender-inclusive and women-targeted training programs, trade fairs, institutional support, and advocacy targeting the specific needs and constraints faced by women entrepreneurs; and (v) its recent adoption of the first Women's National Business Agenda in February 2009.
V. PROJECT BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS

A. Benefits and Impacts

63. Since SMEs are private sector entities, the benefits of pursuing private sector-led regional SME development could be significant. More broadly, an emphasis on market-based interest rates for SME credit introduces a sustainable development paradigm in contrast to dependence on government-sponsored, subsidized programs. In this context, financial analysis has been conducted and successful project implementation will develop support for sustaining private sector-driven policies for economic growth.

64. **Rural and nonurban development.** Recognizing that high incidence of poverty and lack of gainful employment opportunities fuel discontent and unrest, the Project’s rural and nonurban development impact contributes to stability in Bangladesh’s less developed areas. Designed to promote SME development, the Project will benefit rural and nonurban SMEs by improving access to credit. From 2009 to 2012, subloans are estimated to generate an 8% increase in SME sector employment as well as an 8% increase in the number of SMEs established throughout the country, primarily in rural and nonurban areas. Employment will help reduce the relatively high incidence of poverty outside the metropolitan areas of Dhaka and Chittagong. The Project’s poverty impact is discussed in the summary poverty reduction and social strategy in Appendix 10.

65. **Institutional.** Through expansion of medium- to long-term credit by PFIs to SMEs, the Project will synergize the SEDF and European Commission access to finance program that supports PFIs through a combination of TA and policy-related work by catalyzing the nonurban and rural outreach of PFIs and the capability of PFIs’ SME credit staff in terms of (i) project appraisal, supervision, credit and portfolio administration; (ii) opportunities to apply relevant risk management and credit scoring techniques; and (iii) improved operational governance of PFIs through transaction-based accountability for corporate governance and anti-money-laundering activities. Mainstreaming best practices in SME financing will also improve portfolio quality over time, which will prompt other financial institutions to increase their rural and nonurban SME portfolios.

66. **Promotion of women entrepreneurs.** A minimum of 15% of the Project’s credit facility earmarked for lending to women entrepreneurs will promote qualified women entrepreneurs by ensuring access to enterprise finance. Furthermore, the associated TA subproject will build women entrepreneurs’ capacity to access finance resources and business services through supporting the Government’s endeavor to promote women entrepreneurs and women-led businesses.

B. Risks

67. Achieving expected impacts will depend on several assumptions that are subject to varying degrees of risks. Mitigation measures are being put in place where feasible. Major risks are seen to be the following:

(i) **SME viability.** The creditworthiness of SMEs in some locations could affect utilization of the Project’s credit facility. ADB’s assessment indicates that PFIs have significant opportunities for lending to viable SMEs outside the metropolitan areas of Dhaka and Chittagong. To enhance SME viability, the Government has provided greater tax incentives for SMEs located outside the metropolitan areas than those located in metropolitan areas.

(ii) **Delinquency.** Delinquency risks that PFIs face in expanding their SME portfolios outside the metropolitan areas of Dhaka and Chittagong are mitigated through (a) improved access to credit information; (b) risk-based pricing; (c) Bangladesh Bank monitoring; and (d) setting up dedicated SME units staffed with capable personnel, efficient systems, and proper procedures.
(iii) **Implementation.** While the demand for SME credit is robust, there could still be implementation delays if the eligible PFIs refocus their priorities and/or fail to sustain expected performance standards. These risks have been dealt with by assessing PFI eligibility and commitment up front. In addition, the Project enables removal of PFIs in case of performance shortcomings.

(iv) **Complementary support.** The risk of complementary support not progressing as envisaged is not considered significant. The Government fully realizes that macroeconomic stability requires structural and sector reforms. In particular, the Government has reemphasized financial and fiscal reforms.

(v) **Private sector perception.** Private investors’ perceptions are critical for the flow of investment in SMEs outside the metropolitan areas of Dhaka and Chittagong. Measures under the Project to sustain investor confidence include PFIs’ commitments up front to provide credit to viable SMEs. For its part, the Government has given priority to reducing regional inequalities by facilitating public infrastructure development, particularly in nonmetropolitan areas. The enabling environment for SMEs is also being enhanced.

(vi) **Governance and anticorruption.** Based on the governance and anticorruption risk assessment, 10 risks have been identified along with proposed mitigation measures (Appendix 13, Table A13.2).

68. **Environmental and social safeguard policies.** The Project is classified category FI in accordance with ADB’s *Environment Policy* (2002). An EMS framework endorsed by the Government on behalf of the PFIs is in Appendix 4. The Project will not trigger ADB’s *Involuntary Resettlement Policy* (1995). The Project will not have any impacts on indigenous peoples or ethnic minorities and will not trigger ADB’s *Policy on Indigenous Peoples* (1998). An annual environmental compliance monitoring report will be submitted by the PFIs to ADB through Bangladesh Bank.

**VI. ASSURANCES AND CONDITIONS**

**A. Specific Assurances**

69. In addition to the standard assurances, the Government and Bangladesh Bank have given the following assurances, which are incorporated in the legal documents.

(i) The PFIs, subborrowers, and subprojects will at all times comply with the eligibility criteria agreed with ADB;

(ii) The PFI onlending rates for subborrowers will reflect the cost of funds plus a spread that covers transaction costs and risk adjusted returns;

(iii) The PFIs will ensure a wide geographical and sectoral dispersion of the subloans and give preference to underdeveloped areas and priority sectors as outlined in the Government's Industrial Policy;

(iv) A minimum of 15% of the subloans will be earmarked by the PFIs for lending to women entrepreneurs to ensure access by women subborrowers (the earmarked funds that are not utilized within a period of two years of loan effectiveness will revert to the general pool);

(v) The gender action plan for the Project, prepared in consultation with the Government and approved by ADB, will be implemented in accordance with its terms; adequate resources will be allocated for its implementation; and key gender outcome and output targets will be monitored regularly and achieved.

(vi) No subproject will be financed that may have a significant adverse environmental impact, and which could be classified as a Category A subproject pursuant to ADB’s *Environmental Policy* (2002), or which could have resettlement impact, or affect indigenous peoples, under ADB’s safeguard policies;
(vii) Prior to approval of any subloan, each PFI will (a) establish and/or update its EMS in accordance with the EMS framework agreed between the Government and ADB; (b) have an environmental safeguard specialist as staff or consultant; and (c) train and deploy adequate number of its staff to conduct environmental due diligence, review, monitoring, and reporting of subprojects in accordance with the EMS. Each PFI will ensure that the subprojects are implemented in compliance with the EMS.

(viii) The legal and institutional reforms initiated for SME development in Bangladesh will be sustained, and capacity development of the key SME agencies continues during the Project implementation period and thereafter; and

(ix) the Government will continue to implement the mitigation measures described in governance and anticorruption risk assessment agreed with ADB.

B. Condition for Loan Effectiveness

70. Prior to the effectiveness of the Loan, the Administration Agreement, in form and substance satisfactory to ADB, shall have been duly executed and delivered on behalf of the Borrower and Bangladesh Bank, and shall have become fully effective and binding upon the Borrower and Bangladesh Bank in accordance with its terms.

VII. RECOMMENDATION

71. I am satisfied that the proposed loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan in various currencies equivalent to Special Drawing Rights 48,927,000 to the People’s Republic of Bangladesh for the Small and Medium-Sized Enterprise Development Project from ADB’s Special Funds resources with an interest charge at the rate of 1.0% per annum during the grace period and 1.5% per annum thereafter; a term of 32 years, including a grace period of 8 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft Loan and Project Agreements presented to the Board.

Haruhiko Kuroda
President

25 August 2009
## DESIGN AND MONITORING FRAMEWORK

<table>
<thead>
<tr>
<th>Design Summary</th>
<th>Performance Targets/Indicators</th>
<th>Data Sources/Reporting Mechanism</th>
<th>Assumptions and Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Impact</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contributing to continuing economic growth and poverty reduction through development and growth of the SME sector</td>
<td>Real GDP growth sustained at an average of more than 5.5% over 2009–2012</td>
<td>Economic reports and official statistics of the Government and other international development agencies</td>
<td><strong>Assumptions</strong> Continued strong commitment for reforms</td>
</tr>
<tr>
<td></td>
<td>National poverty incidence reduced by 2% over 2009–2012</td>
<td>Periodic reports from Bangladesh Bank</td>
<td>Global economy recovers from financial crisis</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>Risk</strong> Weak implementation of reforms</td>
</tr>
<tr>
<td><strong>Outcome</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Enhanced growth in the number and size of commercially viable SMEs, especially SMEs in rural and nonurban areas with emphasis on women-led SMEs, as well as increased employment in the SME sector</td>
<td>8% increase in number of SMEs established throughout the country including nonurban and rural areas over the next 3 years (current total of 830,000 nonmetropolitan SMEs)</td>
<td>Economic reports and official statistics of the Government and other international development agencies</td>
<td><strong>Assumptions</strong> Macroeconomic stability</td>
</tr>
<tr>
<td></td>
<td>8% increase in SME sector employment over the next 3 years (18.26 million people currently employed in SME sector in nonmetropolitan areas)</td>
<td>Periodic reports from Bangladesh Bank</td>
<td>Commitment to reforms</td>
</tr>
<tr>
<td></td>
<td>10% increase in women-led SMEs in three pilot sites (2009 baseline)</td>
<td>Periodic reports from BWCCI</td>
<td>Project design is able to be implemented</td>
</tr>
<tr>
<td><strong>Outputs</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Expansion of medium- to long-term credit by PFIs to SMEs located outside the metropolitan areas of Dhaka and Chittagong, with emphasis on women-led SMEs</td>
<td>SME credit to total credit ratio of PFIs increased by 5% from 2009 to 2012 (43% of the total SME lending portfolio of the country is currently in nonmetropolitan areas)</td>
<td><strong>Assumption</strong> Effective functioning of SME departments of PFIs</td>
<td><strong>Risk</strong> PFI lending to SMEs leads to higher nonperforming loans because of operational risks</td>
</tr>
<tr>
<td></td>
<td>A minimum of 15% of the credit facility is disbursed to women entrepreneurs in 2009–2012</td>
<td>PFI compliance reports to Bangladesh Bank</td>
<td></td>
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<tr>
<td></td>
<td>Number of successful applications by women entrepreneurs at scheduled commercial banks increased (20% annual increase compared with 2009 baseline)</td>
<td>PFI annual reports</td>
<td>Commitment of Bangladesh Bank and PFIs to implement gender-responsive regulations</td>
</tr>
<tr>
<td>2. Enhanced capacity of women entrepreneurs and associations to fully access the financial resources earmarked for women-led SMEs under the Project</td>
<td></td>
<td>Bangladesh Bank annual reports</td>
<td></td>
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<td></td>
<td></td>
<td>Information and data collected</td>
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<td></td>
<td></td>
<td>Proceedings from regional consultations</td>
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<td></td>
<td></td>
<td>TA final report</td>
<td></td>
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</table>
Activities with Milestones

1. Providing access to credit (continuous, beginning no later than Q4 2009)
   1.1 Disbursement to PFIs
   1.2 Onlending from PFIs to SMEs

2. Developing capacity of women entrepreneurs (continuous, beginning no later than Q4 2009)
   2.1 Advocacy for the enforcement of gender-responsive regulations
      2.1.1 Design, develop, and deliver orientation and training program of bank and PFI officials
      2.1.2 Provide legal aid and literacy services to women entrepreneurs and associations
   2.2 Advocacy for gender-responsive policy reform
      2.2.1 Support ongoing efforts to engage with relevant government entities, banks, PFIs, and local bodies; and advocate for gender-responsive policy and legal and regulatory reforms and simplification of procedures
   2.3 Technical capacity of selected women entrepreneurs and associations strengthened
      2.3.1 Design women entrepreneurship development and business management training programs as required
      2.3.2 Carry out training activities
      2.3.3 Organize exposure visits, trade fairs, and lateral learning initiatives

3. Project supervision and administration
   3.1 Conduct reviews
      3.1.1 Government, ADB, and Bangladesh Bank meetings (once every 6 months)
      3.1.2 ADB review missions (once every 6 months)
   3.2 Prepare and submit:
      3.2.1 Project monitoring reports (quarterly)
      3.2.2 Project review reports (annual and midterm)
      3.2.3 Project completion report (Q4 2012)

Inputs

- ADB Special Funds resources: $76.00 million
- Bangladesh Bank’s credit contributions: $19.00 million
- PFIs’ credit contributions: $19.00 million
- SMEs’ contributions: $12.67 million
- TA resources (Australia–ADB South Asia Development Partnership Facility): $0.50 million

ADB = Asian Development Bank, BWCCI = Bangladesh Women Chamber of Commerce and Industry, GDP = gross domestic product, PFI = participating financial institution, Q = quarter, SMEs = small and medium-sized enterprises, TA = technical assistance.
SMALL AND MEDIUM-SIZED ENTERPRISE SECTOR ANALYSIS

1. **Overview.** The small and medium-sized enterprise (SME) sector is critical for output growth and employment creation since SMEs account for (i) 99% of private sector industrial establishments in Bangladesh, (ii) about 25% of gross domestic product (GDP), and (iii) more than 75% of employment in the private sector in Bangladesh. Nevertheless, SMEs are not realizing their full potential for contributing to Bangladesh’s economic growth and employment. Strong SME growth could therefore underpin Bangladesh’s drive to achieve prosperity and increase employment.

A. **Major Constraints Facing SMEs**

2. **Productivity analysis** indicates that smaller metropolitan firms are more productive than larger ones in many industries. This suggests that, with efficient factor markets, resources should be more appropriately redirected to assist these enterprises under suitable incentives. Yet, small entrepreneurs are poorly skilled and educated, mostly informal, and most importantly, they have limited access to finance. By limiting resources to these more productive and poverty-reducing sectors, the Bangladesh economy curtails its own productivity growth, income growth, and poverty reduction. As revealed in an investment climate survey, firms emphasize financing and infrastructure constraints as two major impediments to their development.¹

3. **Limited access to finance.** The overall supply–demand gap for SME credit is estimated at Tk165 billion (paras. 11–12). While 75% of nonmetropolitan firms report a need for financing, only 6% of nonmetropolitan enterprises availed of formal finance. In the past 3 years, 3% had borrowed from banks and 3% from nongovernment organizations (NGOs) and/or MFIs. Access to formal finance for larger nonmetropolitan enterprises (employing 10 or more workers) is comparable to that of smaller metropolitan firms, with 32% reporting having a bank loan and 3% with NGO and/or MFI loans.

4. **Scarce medium- and long-term credit.** In metropolitan areas, 69% of lending has a maturity of less than 3 years. A little less than half of the loans have maturities of 1 year. The average loan term for bank loans in nonmetropolitan areas is 17 months, with 75% of loans having a maturity of 1 year. As a result, long-term financing is typically procured through accumulated earnings—leading to underinvestment and lower employment and production growth, especially for SMEs.

5. **Limited credit information.** Limited credit information also hinders financing to the promising SME market. Credit information in Bangladesh is inadequate and unreliable, particularly to nonmetropolitan SMEs. A credit information bureau operated by Bangladesh Bank contains current loan information for all borrowers of financial institutions regulated by Bangladesh Bank. However, the system does not allow small businesses to build up reputation-based credit and borrowers with poor credit cannot be screened.²

6. **Lack of legal framework and system for securing movables.** SME entrepreneurs typically have little land to offer as collateral, but they have movable property ranging from equipment to inventory to receivables. The lack of a functional legal system of registered

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² The system is not computerized and only contains information about current loans above Tk50,000 (not the full banking history of the borrower).
movable property, other than for public limited companies, is constraining the use of movable collateral. Linked to this is the lack of a central registry to ensure the integrity of such collateral.

7. **Limited connectivity to markets.** Connectivity to markets—market linkages, transport, telecommunications, financial, technological, and information exchange—is vital for the growth of peri-urban, small town, and village areas. Low demand is perceived as the most serious obstacle to doing business in nonmetropolitan areas, linked significantly to low access to larger markets.

8. **Inadequate physical infrastructure.** In addition to limited access to finance, Bangladeshi firms have identified the primary hindrances for private sector competitiveness as (i) inadequate and poor quality infrastructure (such as roads and energy supply), and (ii) difficulty in obtaining land (especially serviced land). These are more severe for nonmetropolitan firms than for metropolitan firms. Serviced land is the single defining (or limiting) factor of new or expanding entrepreneurs.

9. **Disadvantaged women SME entrepreneurs.** Women entrepreneurs are less educated and have significantly less access to enterprise finance. The rates of women entrepreneurship are lower among rural nonfarm enterprises compared with metropolitan firms. Nonmetropolitan enterprises owned by women are smaller, younger, more likely to be informal, and home-based.

10. The lack of finance, infrastructure, and market connectivity reinforce one another and exacerbate the difficulties SMEs face in doing business. The constraints are more severe for SMEs in the nonmetropolitan/rural and nonurban areas (i.e., outside the metropolitan areas of Dhaka and Chittagong), and this contributes to mounting regional disparity.

**B. Overall SME Credit Demand Analysis**

11. The market size for loans to SMEs is estimated to be nearly Tk255 billion, with 226,000 potential clients (Table A2.1). This estimate is based on the following calculations:\(^3\)
   (i) An estimated 5.9 million micro, small, and medium-sized enterprises in 2003—which, based on population growth, suggests 6.8 million such businesses in 2006.
   (ii) Only 2.5 million of the 6.8 million enterprises are estimated to have annual profits above Tk50,000.
   (iii) Survey findings indicate that 84% of enterprises want to borrow. Of these, only about half will be both willing and able to borrow at a given time (based on the assumption that 70% of firms that want to borrow are creditworthy and that 70% of these are borrowing at the same time). This means that 1 million micro, small, and medium-sized enterprises are potential borrowers.
   (iv) About 78% of these enterprises are micro, 17% small, and 5% medium-sized.
   (v) The potential lending volume for each segment is calculated by multiplying the number of enterprises in that segment by the average loan for that segment. Average loans are determined by the mean for each segment as defined by this report—Tk50,000–Tk300,000 for microenterprises; Tk300,000–Tk1,000,000 for small enterprises; and Tk1 million–Tk5 million for medium-sized enterprises. This result assumes that the midpoint of each segment corresponds to the average expected loan for each segment.

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Appendix 2

Table A2.1: Estimated Credit Demand for Bangladesh’s SMEs

<table>
<thead>
<tr>
<th>Segment</th>
<th>Share of Total (%)</th>
<th>Number of Enterprises</th>
<th>Average Loan size (Tk)</th>
<th>Lending Volume (Tk billion)</th>
<th>Market Share (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro</td>
<td>78</td>
<td>805,477</td>
<td>175,000</td>
<td>140</td>
<td>35</td>
</tr>
<tr>
<td>Small</td>
<td>17</td>
<td>179,366</td>
<td>650,000</td>
<td>117</td>
<td>30</td>
</tr>
<tr>
<td>Medium-sized</td>
<td>5</td>
<td>46,420</td>
<td>3,000,000</td>
<td>138</td>
<td>35</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>1,031,263</td>
<td>3,825,000</td>
<td>395</td>
<td>100</td>
</tr>
</tbody>
</table>


C. Overall SME Credit Supply Analysis

12. As of June 2009, five banks are estimated to have 85% of the market share for SME lending nationwide, which equals a total of Tk75.5 billion (Table A2.2). The remaining banks and financial institutions in Bangladesh hold an estimated 15% market share for SME lending. This suggests an estimated total current supply of SME credit (SME loan principal outstanding) of Tk88.8 billion.

Table A2.2: Estimated Credit Market for Bangladesh’s SMEs

<table>
<thead>
<tr>
<th>Bank</th>
<th>SME Loan Principal Outstanding (Tk billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>BRAC Bank</td>
<td>33.0</td>
</tr>
<tr>
<td>ISLAMI Bank</td>
<td>33.0</td>
</tr>
<tr>
<td>Eastern Bank Limited</td>
<td>3.5</td>
</tr>
<tr>
<td>Dhaka Bank Limited</td>
<td>3.0</td>
</tr>
<tr>
<td>Prime Bank Limited</td>
<td>3.0</td>
</tr>
<tr>
<td><strong>Total SME Lending Volume</strong> (Principal Outstanding)</td>
<td><strong>75.5</strong></td>
</tr>
<tr>
<td><strong>Estimated Market Share of Above Five Banks (%)</strong></td>
<td><strong>85.0</strong></td>
</tr>
<tr>
<td><strong>Total Estimated SME Credit Supply</strong></td>
<td><strong>88.8</strong></td>
</tr>
</tbody>
</table>

SME = small and medium-sized enterprise.
Source: Asian Development Bank estimates.

D. Impact of the Global Financial Crisis on SME Activities and SME Credit Demand

13. SMEs in Bangladesh can be broadly classified into two categories: (i) export-oriented SMEs, and (ii) SMEs geared to the domestic market. The export-oriented SMEs are primarily suppliers to large export-oriented enterprises, e.g., in the ready-made garment subsector. SMEs geared to the domestic market are mainly from the agricultural subsector as well as the poultry, fisheries, and local handloom subsectors.

14. **Export-oriented SMEs and credit demand.** Export-oriented SMEs have witnessed downward pressure on their product prices because of the global recession, resulting in profit margins being squeezed. These SMEs are facing increased deferred payments from larger export-oriented enterprises, so credit demand by export-oriented SMEs has increased to sustain the enhanced cash flow cycle.
15. **SMEs geared to the domestic market and credit demand.** Product prices have remained stable, with an upward trend, since domestic demand has not been affected by the global financial crisis. As a result, producers are finding it conducive to utilize excess capacity and produce more. The increased production levels have therefore increased credit demand by these SMEs.

16. **Enhanced risk and limited growth of large corporations has increased bank focus on SMEs.** The market for lending to large corporations in Bangladesh is highly competitive and presents limited growth opportunities for lenders. Almost all lenders are active in this market, so bank margins are squeezed. Furthermore, the global financial crisis has slowed corporate growth since these firms are large export-oriented enterprises. These corporations are not undertaking any expansion or new projects. With slowing corporate growth, the risk profile of the large corporations has increased for banks since these firms are already significantly leveraged (an average debt–equity ratio of 80:20) and the probability of non-repayment of these large financial charges has consequently increased. Therefore, banks are reluctant to lend to large corporations. In contrast, the SME market for lending has strong growth opportunities for lenders because of a large supply–demand gap for SME credit (paras. 11-12), and it is less competitive as there are fewer lenders in this market compared with the large corporate market. As a result, bank margins are higher. The SME market for lending also poses less risk than the market for large corporations since (i) banks can significantly diversify lending in the SME market by lending a large number of loans (since each loan is small in size), which allows risk to be dissipated; and (ii) SMEs are less leveraged than corporations (an average debt–equity ratio of 60:40 for small enterprises and 70:30 for medium-sized enterprises), which allows room for lending and indicates limited chance of non-repayment (the current repayment rate for SMEs is excellent at 93%–97%, according to participating financial institutions).

17. **Increase in number of SME service centers caused by enhanced SME credit demand and increased bank focus on SMEs.** Increased demand for SME credit and increased bank focus on SME lending (over the past 3 years, total SME lending volume has expanded by an average of 55% per year), caused Bangladesh Bank to approve the opening of 139 SME service centers by the banking sector in 2009. In 2008, 88 SME service centers were opened to facilitate SME lending and other SME banking needs. The SME service centers in 2008 and 2009 were primarily opened by private banks. These centers enhanced the outreach of banks as they are located in underdeveloped areas that are underserved by banks. The centers operate like branches but are subordinated to branches. The private sector-driven trend increase in the number of SME service centers opened in 2009 compared with 2008 provides concrete evidence of enhanced SME credit demand, especially in rural and nonurban areas, despite the global financial crisis.

E. **Summary Analysis of Key SME Subsectors**

18. A number of SME subsectors were studied carefully at the project preparatory stage to examine their potential to enhance SME sector growth and help the economy recover in the context of the projected economic slowdown from the global financial crisis. A summary analysis of key SME subsectors follows (more detailed analysis is in Supplementary Appendix A).

19. **Ready-made garments subsector.** The ready-made garments subsector is the largest foreign exchange earner in Bangladesh, accounting for about 79% of total export earnings and
12% of GDP in 2009.\textsuperscript{4} There have been more than 4,000 ready-made garment businesses, which generate 2.5 million jobs and are the largest employer for women.\textsuperscript{5} The sector can be divided into two broad categories—woven and knit products. Knitwear garment exports have been increasing since the early 1990s and now surpass woven exports. The United States and the European Union are the largest importers of Bangladeshi ready-made garment products, accounting for more than 90% of total ready-made garment exports.

20. **Jute subsector.** Jute and jute-related industries are an important part of Bangladesh’s heritage. The sector has contributed significantly to the country’s economic development. About 20% of the total population is directly or indirectly involved in the sector, and jute production accounts for an average 4% of total GDP. It was once the highest foreign reserve earner, contributing to over 80% of Bangladesh’s foreign exchange reserves. From the 1980s, its share began to decline as synthetic substitutes and artificial fibers emerged. Although jute export has declined to less than 5% of total export earnings, it is still a major sector of the national economy. Its foreign exchange earnings still reach about $300 million annually, and it is one of the major cash crops in the country.

21. **Leather goods subsector.** The leather goods subsector is another key economic sector in Bangladesh. It is smaller in size, employment, and business investment than the textile sector—contributing 0.31% to GDP in FY2003 (constant prices). All the leather goods businesses are privately owned and a few belong to multinational corporations. The majority employ fewer than 50 people and are export-oriented.

22. **Agribusiness subsector.** Bangladesh is predominantly an agricultural country. Agriculture is the engine of growth of the economy. The overall contribution of the broad agriculture sector is estimated at 20.87% of GDP in 2007–2008. About 48.1% of the total labor force is directly or indirectly engaged in the agriculture sector. In FY2007–FY2008, export earnings from agricultural products were $987.56 million—7.0% of total export earnings. Agribusiness is related to the commercial production of agricultural commodities (including crops, livestock, fisheries, and forestry); transformation of agricultural commodities into products; provision of inputs to the production of agricultural commodities (including planting and genetic material, agrochemicals, equipment, and pharmaceuticals); and the marketing and distribution of agricultural commodities and products.

23. **Plastic products subsector.** There are about 3,000 plastic businesses in Bangladesh. Over half have less than 24 employees. The country has seen a dramatic increase in plastic exports in recent years. It contributed to foreign exchange revenues worth several billion taka and has the potential to become one of the country’s top 10 exports. More than 200,000 skilled and unskilled people are employed in this sector, which manufactures moldings and other products for garment accessories, toys, toothbrushes, ballpoint pens, shoes, pharmaceutical packages, bottles, pipes, and plastic wrapping. Bangladeshi plastic goods are exported to 23 countries. The plastic industry has played an important role as a backward linkage for various upstream industry sectors such as garments, medicine, and food processing.

24. **Information and communication technology subsector.** Telephone density in Bangladesh is among the lowest in the world. Telephone coverage has been improved by the

\textsuperscript{4} Source: Bangladesh Bank 2009 and Asian Development Bank estimates. From July 2008 to March 2009, ready-made garment exports accounted for 79% of total export earnings ($9.2 billion out of a total of $11.7 billion). This may be compared with the estimated GDP for 2009 of about $80 billion.

\textsuperscript{5} About 80% of ready-made garment jobs are held by women.
Grameen Phone, but there is still room for further growth. Bangladesh’s information and communication technology (ICT) subsector is not large, estimated at less than $200 million, but it is growing rapidly at about 20% a year. SME ICT businesses include (i) support and consulting services for various types of ICT work, such as internet services providers; (ii) contracting and technical and services support for mobile phone and fixed-line carriers; (iii) software development; and (iv) other ICT-related businesses such as data processing, automation, and call centers. Private sector involvement, particularly SMEs, is an integral part of this development process. The ICT sector contributes to the overall development process and poverty alleviation efforts through employment generation, economic expansion, and exports. The rapid expansion of mobile telephony and the internet greatly facilitate the business process and economic efficiency.

25. **Light engineering subsector.** The light engineering subsector supports basic industry functions in Bangladesh. The subsector consists of about 7,000 firms, employs 800,000 persons, and generates annual revenue of about $1.6 billion or about 2% of annual GDP. The subsector manufactures a wide variety of parts, tools, and light machinery that supply all aspects of the national industries such as agriculture, food processing, chemical, transport, construction, and others. Improvement of operating efficiency, industry linkage, investment, and access to finance are among the important steps to combat the dampened domestic and international demand.

26. **Handicrafts and silk subsector.** Handicrafts are produced by family-based small manufacturing units to produce articles such as baskets, pottery, wall hangings, handbags, carpets, and embroidered quilts. Handicrafts and cottage industries contribute to an important part of foreign exchange earnings, generating employment and creating opportunities to utilize indigenous natural resources. Members of crafts families or cooperatives are employed in the handicraft production unit at the cottage level, providing the necessary linkages to SMEs. The handicraft sector is considered a key area for future expansion in terms of export potential. With the low cost of labor and rich cultural heritage in Bangladesh, the subsector has a clear advantage in the world market. The structure of the silk subsector is similar to that of the handicraft sector. Silk production is highly labor-intensive and provides an excellent opportunity for rural development, particularly in women entrepreneurship.

**F. Growth Impediments and Interventions in the SME Sector**

27. Preparatory work and complementary reforms have already been undertaken to help accelerate SME sector development (Table A2.3).

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6 Grameen Bank borrowers, mostly women, were given loans of about $350 each to cover the cost of the telephone, the hook-up, training, and repair services to provide telephone services in their villages. They purchase air time at wholesale prices from Grameen Telecom and sell the telephone service to fellow villagers at the market rate. They act as human pay phones in places where there are no landlines and no one has even seen a telephone or made a phone call.

7 Including system software, system infrastructure, and application software.
### Table A2.3: SME Sector Growth Impediments and Interventions

<table>
<thead>
<tr>
<th>Impediment to SME Sector Growth</th>
<th>Intervention</th>
</tr>
</thead>
<tbody>
<tr>
<td>Absence of secured transaction bill</td>
<td>Enactment of secured transaction bill by December 2009.</td>
</tr>
<tr>
<td>Absence of credit rating information system for SME borrowers</td>
<td>Government is facilitating the automation of the credit information bureau at Bangladesh Bank to ensure availability of credit history for all SMEs through a DFID and IFC project to be completed by September 2010. Furthermore, Dun &amp; Bradstreet, will commence operations in Bangladesh by December 2009 with the specific task of assigning credit ratings to SMEs.</td>
</tr>
<tr>
<td>Inadequate physical infrastructure</td>
<td>Through public–private partnerships as well as through ADB, DFID, and the World Bank, the Government will increase its focus on infrastructure.</td>
</tr>
<tr>
<td>Absence of medium- to long-term credit for SME borrowers</td>
<td>Provision of sustainable medium- to long-term credit for SME borrowers through ADB’s proposed Project and continuing support through various ADB and World Bank projects for developing the domestic capital market.</td>
</tr>
<tr>
<td>Concentration of SME lending in the eastern part of the country, mainly in Dhaka and Chittagong</td>
<td>Provision of SME lending outside the metropolitan areas of Dhaka and Chittagong through ADB’s proposed Project.</td>
</tr>
<tr>
<td>Limited connectivity to markets</td>
<td>Market activity is being enhanced to strengthen technological, financial, and information exchange between larger and smaller companies, as well as urban and rural ones through Government initiatives and extensive development partner TA support.</td>
</tr>
<tr>
<td>Disadvantaged SME female entrepreneurs</td>
<td>A portion of the Project’s credit facility is allocated for lending to qualified women entrepreneurs to ensure access to enterprise finance and empowerment of female entrepreneurs. In addition to Government initiatives and ongoing TA support by development partners, the associated TA will enhance women entrepreneurs’ capacity to fully access and optimally utilize the financial resources earmarked for them under the Project.</td>
</tr>
</tbody>
</table>

**Sources:**
- ADB = Asian Development Bank
- DFID = Department for International Development of the United Kingdom
- IFC = International Finance Corporation
- SMEs = small and medium-sized enterprises

**Source:** Asian Development Bank.
## EXTERNAL COORDINATION MATRIX

<table>
<thead>
<tr>
<th>Name of Organization</th>
<th>Type of Assistance</th>
<th>Major Activities</th>
<th>Amount</th>
<th>Time Frame</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Financial Sector</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Bank</td>
<td>Loan</td>
<td>The World Bank is strengthening the capacity of the Bangladesh Bank through the Central Bank Strengthening Project to enable Bangladesh Bank to play its due role as the country's monetary authority, bank regulator, and supervisor.</td>
<td>$37 million</td>
<td>June 2003–December 2009</td>
</tr>
<tr>
<td>World Bank</td>
<td>Loan</td>
<td>The Enterprise Growth and Bank Modernization Project is supporting the Government's policy of reducing, and eliminating over time, its ownership of assets in the real and financial sectors of the economy. Such a policy, which will ultimately help in reducing the fiscal deficit through reduction and elimination of losses, will also foster private sector development and growth through more productive use of state-owned enterprise assets.</td>
<td>$250 million</td>
<td>June 2004–December 2010</td>
</tr>
<tr>
<td><strong>Physical Infrastructure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>World Bank</td>
<td>Loan</td>
<td>The Investment Promotion and Finance Facility Project aims to increase competition and transparency in infrastructure finance through supporting private sector participation and market-based solutions. It will supplement the resources of Bangladesh's financial markets to provide long-term finance for infrastructure projects, which are beyond the capacity of local financial institutions.</td>
<td>$50 million</td>
<td>May 2006–December 2011</td>
</tr>
<tr>
<td>DFID, World Bank</td>
<td>Loan</td>
<td>The Private Sector Development Support Project is supporting interventions in three complementary areas: (i) streamlining the regulatory interface between government and business, (ii) facilitating the focused provision of land and infrastructural services through an efficient industrial zoning program, and (iii) building capacity in key government agencies working on private sector development issues, such as the Board of Investment, Bangladesh Export Processing Zones Authority and selected government ministries.</td>
<td>$150 million</td>
<td>November 2006–November 2012</td>
</tr>
<tr>
<td><strong>Enabling Environment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>European Commission</td>
<td>TA</td>
<td>The European Commission will approve TA grant amounting to €19 million for Integrated Support to Poverty and Inequality Reduction through Enterprise Development with the following three components: (i) improving the national strategy and enabling environment for small enterprises in preparation for a sector-wide approach to SME development in Bangladesh, (ii) enhancing SME competitiveness through business intermediary organizations, and (iii) introducing sustainable improvements in SME access to appropriate and affordable finance.</td>
<td>€19 million</td>
<td>September 2009–September 2012</td>
</tr>
<tr>
<td>IFC-BICF</td>
<td>TA</td>
<td>The IFC Bangladesh Investment Climate Fund is a long-term technical program targeting a better operating environment for businesses. Its objectives are consistent with the Bangladesh Government's strategic vision for private sector development within its poverty reduction strategy. Government agencies and IFC BICF—in close collaboration with the Bangladeshi private sector and civil society—will jointly design and implement programs to institute business-friendly policies, laws and regulations, and strengthen the institutions that implement them.</td>
<td>$55 million</td>
<td>March 2007</td>
</tr>
<tr>
<td>USAID</td>
<td>TA</td>
<td>The USAID commenced an $11 million 5-year TA grant in February 2008 for Poverty Reduction by Increasing the Competitiveness of Enterprises to alleviate</td>
<td>$11 million</td>
<td>February 2008–</td>
</tr>
<tr>
<td>Name of Organization</td>
<td>Type of Assistance</td>
<td>Major Activities</td>
<td>Amount</td>
<td>Time Frame</td>
</tr>
<tr>
<td>----------------------</td>
<td>--------------------</td>
<td>------------------</td>
<td>--------</td>
<td>------------</td>
</tr>
<tr>
<td>CIDA, DFID, SDC, SNV</td>
<td>TA</td>
<td>One of the largest projects in the field of SME promotion in Bangladesh is KATALYST (Developing Business Service Markets). KATALYST aims to improve market access, management and technical skills, quality, and production methods. KATALYST identifies key constraints and opportunities in sectors (such as manufacturing, agriculture, and services) and promotes mechanisms that improve business performance.</td>
<td>$25 million (Phase II)</td>
<td>March 2008–March 2012 (Phase II)</td>
</tr>
<tr>
<td>DFID, IFC</td>
<td>TA</td>
<td>The Government is facilitating the automation of the credit information bureau at Bangladesh Bank to ensure availability of credit history for all SMEs.</td>
<td>$6 million</td>
<td>May 2009–September 2010</td>
</tr>
<tr>
<td>IFC–SEDF</td>
<td>TA</td>
<td>IFC-SEDF commenced phase 2 of its SME development activities in January 2009, which builds upon phase 1 and includes (i) access to finance program that supports PFIs through a combination of TA and policy-related work; (ii) sector development and business services program that facilitates the development of firms providing business development products and services; and (iii) the business enabling environment program that promotes trade, enhances gender development, and develops conducive policy and regulatory frameworks.</td>
<td>$36 million (Phase II)</td>
<td>January 2009–June 2014 (Phase II)</td>
</tr>
<tr>
<td>JICA</td>
<td>TA</td>
<td>JICA is currently undertaking SME activities in Bangladesh through their Private Sector Development Program, which includes SME studies (specifically silk, jute, and software subsectors) on potential subsector growth for export diversification.</td>
<td>—</td>
<td>Ongoing</td>
</tr>
</tbody>
</table>


Source: Asian Development Bank estimates.
ENVIRONMENTAL MANAGEMENT SYSTEM FRAMEWORK

A. Introduction

1. The proposed Project seeks to facilitate the development of small and medium-sized enterprises (SMEs), with specific emphasis on moderating regional disparities. The Project consists of a loan of SDR48,927,000 ($76.0 million equivalent) from the Asian Development Bank’s (ADB’s) Special Funds resources for extending credit through participating financial institutions (PFIs) to SME subprojects outside the metropolitan areas of Dhaka and Chittagong.

2. The PFIs will be pre-identified based on due diligence conducted to analyze their financial aspects as well as to determine their ability to handle social and environmental issues. However, since the facility is aimed at improving access to credit by SMEs, it is deemed appropriate to make the facility available to as wide a number of eligible financial institutions as possible, including those under the ongoing credit line of ADB’s SME Sector Development Program (SMESDP). The due diligence results indicate that most of the PFIs under the ongoing credit line of ADB’s SMESDP will qualify for the credit facility under the Project. Experience from similar credit lines (e.g., the SMESDP) indicates that lending to SMEs is unlikely to involve significant adverse environmental impacts.

3. The PFIs adhere to the rules and regulations of the Ministry of Environment and Forests of Bangladesh. Their current environmental management systems (EMSs) are under review by ADB to improve and sustain EMS implementation, which will benefit the Project and the PFIs.

B. Implementation Arrangements

4. The Executing Agency (EA) for the Project is the Finance Division of the Ministry of Finance, and Bangladesh Bank is the Implementing Agency. Bangladesh Bank has overall responsibility for ensuring that national environmental policies and regulations and ADB’s environmental assessment requirements are adhered to by the PFIs. The Agricultural Credit and Special Programs Department of Bangladesh Bank will administer the Project’s credit facility. As credit delivery institutions, the PFIs commit to updating or establishing and sustaining implementation of EMSs. To ensure successful EMS implementation, the PFIs will allocate staff resources and develop procedures (relevant to the types of subprojects to be funded and nature of their impacts) to screen subprojects, conduct due diligence, review environmental assessment reports, monitor and report on implementation, and evaluate the performance of the EMS for continual improvement. An annual environmental compliance monitoring report submitted by the PFIs through Bangladesh Bank to ADB is required to support ADB’s compliance oversight of the Project.

5. Bangladesh Bank through the PFIs will ensure that the environmental assessment will be undertaken in a participatory manner with the PFIs’ clients. Consistent with government and ADB guidelines, stakeholder consultations will be documented in the environmental assessment documents. Bangladesh Bank will ensure compliance with government regulations on environmental permits, licenses, and clearance. Release of any funds for specific subprojects will be contingent on prior issuance of necessary permits or licenses and clearance by relevant government authorities and/or by ADB, as required.

C. Policies

6. A PFI's EMS embodies policies, procedures, and required capacity. The objectives of the environmental policy are to (i) protect the environment, (ii) encourage the efficient use of natural resources, and (iii) promote environmental improvement where possible. The national policies constitute the basis for EMS polices in the PFIs. All the participating banks will comply with national environmental policies, rules, and regulations. The Bangladesh Environment Conservation Act, 1995, is supported by the Environment Conservation Rules, 1997; the Environment Court Act, 2000; the Water Pollution Control Ordinance, 1970; and the Acquisition and Requisition of Immovable Property Ordinance, 1982. Other relevant regulations include bylaws related to pollution control, health and sanitation, and disposal of solid waste: the Mining Settlements Act, 1912; Mines Act, 1923; Motor Vehicles Ordinance, 1983; Agricultural Census Act, 1958; and Antiquities Act, 1968.

7. The PFIs will ensure subprojects’ compliance with national environmental policies and regulations as well as with ADB’s applicable environmental assessment requirements. The national policies and ADB’s environmental assessment requirements reinforce each other.

8. The PFIs will only invest in subprojects
(i) if their activities are outside of the prohibited investment activities list (Supplementary Appendix E);
(ii) that take account of the environmental impacts of their operations and take steps to avoid, minimize, and mitigate any risks;
(iii) that are designed, implemented, and operated in compliance with all government environmental regulations and requirements, as well as with ADB’s requirements, as applicable;
(iv) that will not have a resettlement impact under ADB's Involuntary Resettlement Policy (1995), or affect indigenous peoples under ADB's Policy on Indigenous Peoples (1998); and
(v) that take account of relevant international environmental agreements.

9. The operational principles of a PFI’s environmental policy include
(i) ensuring that environmental safeguards as defined by the Environment Conservation Act, 1995; the Environment Conservation Rules, 1997; as well as rules and regulations issued by the Ministry of Environment and Forests are integrated into project design prior to its financing and complied with during construction and operation;
(ii) adopting a risk classification system in accordance with government procedure or international best practice;
(iii) ensuring that no activities on the “exclusion list” are financed or fostered by PFIs;
(iv) where potential adverse social and environmental impacts are expected, the measures to prevent these from occurring in the first place are preferred to measures seeking minimization, mitigation, or compensation;
(v) disclosing relevant information and consulting with project-affected people for subprojects with potential adverse environmental and social impacts;
(vi) where required to mitigate significant adverse environmental risk, ensuring that relevant international best practices, are integrated into project design, implementation, construction, and operation;
(vii) encouraging project promoters and other project partners to adopt environmentally sound practices;
(viii) where subprojects have potential significant adverse impacts, ensuring independent compliance review by the PFI; and
(ix) ensuring transparency in and commitment to continual improvement of its EMS.

D. Procedure

10. Based on the procedure below, PFIs should develop their own set of procedures and requirements to avoid, minimize, mitigate, manage, and monitor subproject impacts, as appropriate to the types and scale of subprojects, and regarding the nature, sensitivity, and magnitude of subprojects' impacts.

1. Screening

11. Screening measures need to be implemented by the PFI to ensure that subprojects are not in the exclusion list.
   (i) The PFI will screen the proposed subproject to ensure that it is not included in the prohibited investment activities list.
   (ii) The PFI's safeguards specialist will carry out a rapid environmental assessment and prepare a brief report to summarize the results, including issues identified that need to be addressed and the type and scope of environment assessments needing to be conducted to mitigate the potential impacts.
   (iii) Using project classification criteria, the proposed subproject will be classified according to the significance of environmental impacts. The category determines the level and type of environmental assessment (initial environmental examination or environmental impact assessment) to be conducted to address potential environmental impacts.
   (iv) The PFIs will only finance subprojects that will not have a resettlement impact under ADB's Involuntary Resettlement Policy (1995), or affect indigenous peoples under ADB's Policy on Indigenous Peoples (1998).

2. Environment Assessment and Review

12. Environment assessment and review to be undertaken by the PFIs is below.
   (i) After reviewing the proposal, the PFI will recommend the level of environmental assessment to be prepared if a feasibility study has not been prepared for the subproject. If potential environmental impacts are few in number, generally site-specific, largely reversible, and readily addressed through mitigation measures, narrower scope assessments (e.g., initial environmental examination) may be conducted. If potential significant adverse impacts are diverse, irreversible, or unprecedented, a comprehensive environmental assessment, such as an environmental impact assessment, is needed. If an environmental impact assessment is required, it must include an environmental management plan consisting of mitigation measures for identified environmental impacts, staffing, monitoring and reporting arrangements, and budget.
   (ii) If a feasibility study has been done and an environmental assessment report has already been prepared, the PFI will conduct a desk review of the environmental assessment report to ensure the adequacy of the environmental management

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2 Environment assessment report is a generic term that refers to an initial environmental examination, environmental impact assessment, or an environmental audit report.
plan to manage the risks, as well as to ensure compliance with all government environmental regulations and requirements and, as applicable, ADB environmental assessment requirements.

(iii) The safeguards specialist and/or project team will present the initial findings on the environment to the committee (e.g., credit and investment committee), which is responsible for approving the full credit appraisal of the proposed subproject. The safeguard compliance specialist, reporting to the chief compliance officer, will provide an independent view of the risks and assign an environmental risk rating for discussion by the financial committee and credit committee.

(iv) The PFI should ensure that clients comply with the requirement for consultation with project-affected people that is preceded by information disclosure to those people. Information relevant to a subproject’s environmental issues is disclosed and consultation with subproject-affected people is done at the early stage of environmental assessment work so that the views of the affected people are taken into account in project design. For category A projects, consultation should be done twice, with the second consultation process occurring when the draft environmental impact assessment report is available. Consultation will continue during implementation. As required, the PFI will establish a grievance mechanism as part of its project management system.

(v) The PFI will inform its client about applicable government and ADB environmental requirements.

(vi) If the subproject to be funded is an existing facility, the PFI will conduct an environmental audit to determine the nature and extent of all environmental areas of concern at the existing facility. The audit identifies and justifies measures to mitigate the areas of concern, estimate the cost of the measures, and recommend a schedule for implementing them.

(vii) The PFI will conduct a site visit to validate or update the information or to verify the findings of an EA or audit report (if already available).

(viii) For any category A subproject, the PFI will be required to obtain ADB clearance of the environmental assessment. For these category A subprojects, a summary environmental assessment must also be disclosed to the public, and a full round of public consultation must be completed, for a period of at least 120 days before the subproject is approved. A detailed environmental assessment report will be prepared for approval by ADB before the subproject is approved.

(ix) The safeguards specialist will conduct an in-depth review of environmental plans, including the budget. Review will also be made of clearances and permits from the Ministry of Environment and Forests, and relevant local authorities. The legal officer formulates legal agreements with the subproject sponsor on safeguards. The safeguards specialist assists the client in preparing tender documents to ensure implementation by contractors of agreed mitigation measures.

(x) The results of due diligence from the previous steps are reflected in the feasibility and appraisal reports, which highlight the recommended environmental management or corrective action plan to mitigate the risk.

3. Monitoring and Supervision

13. During subproject implementation, the PFIs will monitor and supervise implementation of subprojects with potential adverse environmental impacts. The review and monitoring activities of the PFIs include, but are not limited to, the following activities:

(i) Conducting site visits of projects with environmental risks and impacts. These visits occur during due diligence but more often at the implementation stage.
(ii) Reviewing project performance based on the client’s commitments in the legal agreement, as reported by the client’s monitoring reports, and, where relevant, reviewing with the client any performance improvement requirements.

(iii) If changing project circumstances would result in adverse environmental impacts, revising the environmental management plan and working with the client to address those impacts.

(iv) Requiring clients to notify the PFI immediately of any accidents and incidents (e.g., spillages) that have or are likely to have a material adverse effect on the environment, including any remedial action planned or taken by the company in response to the accident or incident.

(v) If the client fails to comply with its environmental commitments, as expressed in the legal agreement, working with the client to bring it back into compliance to the extent feasible, and, if the client fails to reestablish compliance, exercising remedies when appropriate.

4. Reporting

14. The PFIs will prepare and submit annual environmental compliance monitoring reports to ADB within 90 days after the close of their respective financial years.

15. In the event that a significant environment-related accident or incident occurs in a subproject, the PFI will notify the project steering committee and ADB immediately upon becoming aware of the matter and indicate the proposed corrective actions to be taken. Upon the request of ADB, the PFI will arrange access for ADB staff to visit subprojects to verify compliance with ADB’s environmental policies.

E. Use of Independent Experts

16. Financial intermediaries for subprojects with potential significant adverse impacts may commission independent environmental experts to conduct full or partial environmental audits if the information collected at screening or any other stage indicates potentially significant environmental risks and liabilities (e.g., caused by regulatory noncompliance or site contamination).

F. Capacity

17. The PFIs will endeavor to achieve high standards of EMS practice by recruiting staff or consultants with environmental management skills and through in-house or external training programs. Some specialist staff will be required to drive the internal process. A senior member of the management team will be appointed to drive the program internally and take responsibility for designing, if applicable, and implementing the EMS. All activities related to the environment will be coordinated by a dedicated environment staff member in the projects department.

18. In addition, it is recommended that a separate function of the EMS compliance specialist be established to assist the credit function in evaluating, monitoring, and managing all matters involving EMS risk.

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3 The PFIs are encouraged to send representatives to participate in relevant training programs sponsored by the SouthAsia Enterprise Development Facility of the International Finance Corporation.
19. By providing additional training, as required, the PFI s will ensure that their safeguards specialists are qualified to play their roles and to discharge their responsibilities.

G. Guidelines and Handbook

20. The PFI s are also to have available an environmental guidebook for clients to provide guidance on applicable environmental requirements and good practices.
ELIGIBILITY CRITERIA FOR PARTICIPATING FINANCIAL INSTITUTIONS,
SUBBORROWERS, AND SUBPROJECTS

1. **Participating financial institutions.** PFIs will be pre-identified based on due diligence conducted to analyze their financial aspects as well as to determine their ability to handle social and environmental issues. However, since the facility is aimed at improving access to credit by SMEs, it is deemed appropriate to make the facility available to as wide a number of eligible financial institutions as possible. The due diligence results indicate that most of the PFIs under the ongoing credit line of ADB’s SMESDP will qualify for the credit facility under the Project. A summary of the due diligence analysis of eligible PFIs from ADB’s SMESDP is in Appendix 6. The PFIs must comply with the following eligibility criteria:

   (i) **SME lending commitment and capacity of PFIs.** Each PFI must have (a) lending policies and strategy related to SMEs, and (b) a track record of performance in relevant SME sector lending.

   (ii) **PFI operational and financial eligibility criteria.** Each PFI should be in compliance with all applicable prudential regulations and guidelines of Bangladesh Bank, including but not limited to those for (a) minimum capital of 9% on a risk-weighted basis; (b) recognition of income; (c) loan classification; (d) loan provisioning; (e) overall nonperforming loan ratio and nonperforming loan ratio for SME loans; and (f) anti-money-laundering procedural requirements. Moreover, each PFI must at least have a credit rating of BBB- (moderate degree of safety for timely repayment of financial obligations), in accordance with the Bangladesh long-term national rating scale of Credit Rating Information and Services Limited or an equivalent rating by a credit rating agency acceptable to ADB. Each PFI must at least maintain this grade throughout the life of the Project. Provisions will be included in each participation agreement between Bangladesh Bank and a PFI that require the PFI to (a) maintain financial soundness; (b) conduct its operations in accordance with sound financial principles and practices; (c) maintain a lending and investment policy acceptable to ADB and Bangladesh Bank to enable it to effectively appraise the financial, technical, environmental, and economic feasibility of investment projects; and (d) supervise and monitor the implementation of investment projects by beneficiaries. ADB reserves the right to disallow disbursements from the credit facility of any PFI not conforming with any of the above criteria until such time as the PFI is able to satisfy the criteria. Such PFI shall be required to remedy any default of eligibility criteria within 6 months of default and in any event, within the disbursement period of the Project.

   (iii) **PFI corporate governance.** Each PFI has to demonstrate compliance with Bangladesh Bank’s measures\(^1\) for corporate governance of banks and financial institutions, which include (a) corporate governance structures that promote effective identification, monitoring, and management of all material business risks; (b) systems for ensuring compliance with all statutory and regulatory requirements; (c) implementation of financial disclosure requirements for market participants and observers; and (d) setting of corporate governance objectives, strategies, and techniques.

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\(^1\) Bangladesh Bank is deploying continuous effort to put in place good corporate governance in banks by inserting appropriate provisions in the Banking Companies Act, 1991, and Financial Institutions Act, 1993, supplemented by prudential regulations and guidelines in line with international best practices.
(iv) **SME outreach.** Each PFI must have demonstrated capability for lending to SMEs outside the metropolitan areas of Dhaka and Chittagong as evidenced by branch operations, lending data, as well as plans or availability for providing credit and advisory services. Collaboration between PFIs and NGOs and other civil society institutions is also crucial, as this can facilitate and play an instrumental role in the outreach programs.

(v) **SME risk management procedures.** Each PFI must have demonstrated capability for proper risk management with adequate processes and/or procedures (e.g., credit risk manual) that cover the necessary (a) credit risk, (b) asset liability risk, and (c) operational risk. The PFI should have the control structure and capacity to systematically evaluate credit risk appraisal, asset–liability management, internal control and compliance, as well as market risks (e.g., interest rate risk and foreign exchange risk).

(vi) **Compliance.** Each PFI must have environmental and social safeguards management systems designed to identify, remedy, and monitor subprojects' compliance according to ADB's environmental and social safeguard policies.\(^2\)

2. ADB reserves the right to disallow disbursements to any eligible PFI for not conforming to any of the eligibility criteria until the PFI is able to satisfy the established criteria.

3. **Subborrowers.** The following are eligible to access the Project’s credit facility:

   (i) Start-up SMEs as well as SMEs undertaking expansion or modernization, provided their fixed assets do not exceed Tk200 million (excluding land and building) and/or their maximum workforce does not exceed 150 employees.\(^3\)

   (ii) Qualified women entrepreneurs will be given preference to access the facility. At least 15% of the credit line under the Project will be earmarked for lending to qualified women entrepreneurs.

4. **Subprojects.** The subproject selection criteria has been designed for outreach to nonmetropolitan SMEs. The subproject will:

   (i) be located outside the metropolitan areas of Dhaka and Chittagong and have a wide geographical and sectoral dispersion (preference will be given to underdeveloped areas as outlined in the upcoming Industrial Policy, 2009);

   (ii) be economically and financially viable;

   (iii) be for start-up, expansion, or modernization activities in any of the eligible subsectors\(^4\) as agreed between the Government and ADB;

   (iv) comply with the environmental and social safeguard policies of the Government and ADB, and not involve activities in ADB’s prohibited investment activities list (Supplementary Appendix E); and

   (v) not entail any activities that may have significant adverse environmental impact, which could be classified as Category A subproject pursuant to ADB’s *Environment Policy* (2002) or which could have resettlement impact or affect indigenous peoples under ADB’s social safeguard policies.

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\(^2\) Each PFI will provide such written policies and procedures.

\(^3\) As defined in footnote 5 of the main text. The SME definition may be amended in line with the upcoming Industrial Policy, 2009.

\(^4\) Except those on the prohibited investment activities list of ADB.
DUE DILIGENCE SUMMARY OF
PRE-IDENTIFIED PARTICIPATING FINANCIAL INSTITUTIONS

1. Since the credit facility under the proposed Project is aimed at improving access to finance by small and medium-sized enterprises (SMEs), it is deemed appropriate to make the facility available to as wide a number of eligible financial institutions as possible. The due diligence results indicate that most of the participating financial institutions (PFIs) under the ongoing credit line of the Asian Development Bank (ADB) SME Sector Development Program (SMESDP)\(^1\) will qualify for the credit facility under the Project. The following criteria were assessed to pre-identify these PFIs. First, qualitative indicators include ownership structure, corporate governance practice, and risk management procedures and capacity, including internal audit and controls. Second, quantitative indicators include credit ratings; capital base and adequacy; and financial performance such as earnings, liquidity, asset quality, and/or operating efficiency. Third, pre-identification conditions include banking license, operating track record, commitment in SME lending, and SME coverage. The following is a summary of the due diligence analysis of eligible PFIs from ADB’s SMESDP. The detailed due diligence report on the 24 financial institutions is in Supplementary Appendix B.

2. **Bangladesh Finance and Investment.** Bangladesh Finance and Investment has the necessary legal and institutional prerequisites to establish its initial eligibility. Despite limitations in corporate governance and risk management, the company has adequate capital, improving financial performance, positive operating efficiency, proper capital adequacy, and a credit portfolio that covers industry sectors such as leasing, term finance, working capital, syndicate finance, real estate finance, and SME finance. The rating by Credit Rating Information and Services Limited (CRISL)\(^2\) for Bangladesh Finance and Investment is BBB– in the long term and ST-4 in the short term. Overall performance has the potential to improve.

3. **Bangladesh Industrial Finance.** Bangladesh Industrial Finance has the necessary legal and institutional prerequisites to establish its initial eligibility. It is a joint venture leasing and financing company with a wide range of product lines, including lease finance, term loan, equity finance, and short-term loan. Company ownership is somewhat concentrated, and corporate governance needs improvement. However, daily business operations are not materially affected. Risk management is appropriate, with a separate credit risk management committee, and there is proper oversight on operational risk and market risk. Bangladesh Industrial Finance is compliant with Bangladesh Bank requirements regarding paid-up capital, statutory reserve, and general reserve levels. The rating by Credit Rating Agency of Bangladesh Limited (CRAB)\(^3\) for Bangladesh Industrial Finance is BBB2 in the long term and ST-3 in the short term as of May 2008. The overall performance is acceptable.

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\(^1\) ADB. 2004. *Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the People’s Republic of Bangladesh for the Small and Medium Enterprise Sector Development Program*. Manila.

\(^2\) CRISL long-term rating scale range: AAA (Highest Safety); AA+, AA, AA- (High Safety); A+, A, A- (Adequate Safety); BBB+, BBB, BBB- (Moderate Safety); BB+, BB, BB- (Inadequate Safety); B+ B, B- (Risky); CCC+, CCC, CCC- (Vulnerable); CC+, CC, CC- (High Vulnerable); C+, C, C- (Near to Default); and D (Default). CRISL short-term rating scale range: ST-1 (Highest Grade), ST-2 (High Grade), ST-3 (Good Grade), ST-4 (Satisfactory Grade), ST-5 (Non-Investment Grade), and ST-6 (Default).

\(^3\) CRAB long-term rating scale range: AAA (Highest Quality); AA1, AA2, AA3 (Very High Quality); A1, A2, A3 (High Quality); BBB1, BBB2, BBB3 (Medium Quality); BB1, BB2, BB3 (Inadequate Quality); B1 B2, B3 (High Credit Risk); CCC1, CCC2, CCC3 (Very High Credit Risk); CC (Extremely High Credit Risk); C (Near to Default); and D (Default). CRAB short-term rating scale range: ST-1 (Highest Grade), ST-2 (High Grade), ST-3 (Average Grade), ST-4 (Below Average Grade), ST-5 (Inadequate Grade), and ST-6 (Lowest Grade).
4. **Bank Asia.** Bank Asia is a top performing financial institution in Bangladesh and it meets most pre-identification conditions for PFI eligibility. The total capital base is sound. The initial public offering in 2003 was 55 times over subscribed. Corporate governance practice is strong, in terms of organization structure, delegation of authority, independence of the management from the board, and the track record of the management. The bank had good exposure in ready-made garments, food, steel, and other SME-related industry sectors, and its branch network is extensive. Such an experience would facilitate future lending to SMEs. Bank Asia implemented the credit risk guidelines as prescribed by Bangladesh Bank. Oversight on operational risk and market risk is also strong. CRAB rated Bank Asia AA2 in the long term and ST-1 in the short term as of May 2008, signaling it a very strong bank. Performance indicators are very positive.

5. **BASIC Bank.** BASIC Bank has the necessary legal and institutional prerequisites to establish its initial eligibility. It is a state-owned development and commercial bank. BASIC Bank is 100% government-owned, and it functions as a development finance and commercial banking institution. Therefore, the corporate governance structure prescribed by Bangladesh Bank for commercial banks is not applicable to BASIC Bank. BASIC Bank's performance does not reflect corporate governance issues. The lending portfolio covers food, textile, jute, forestry, chemical, pharmaceuticals, engineering, electronic, and service areas. Overall risk management is adequate, and it formed an internal committee to create awareness for implementation of Basel II in 2009. CRISL upgraded BASIC Bank's credit rating from A+ to AA- in the long term and from ST-2 to ST-1 in the short term from 2006 to 2007. The financial performance was good but average when comparing to its peers.

6. **Bay Leasing and Investment.** Bay Leasing and Investment has the legal and institutional prerequisites to establish its initial eligibility. In 1996, it obtained a license from Bangladesh Bank as a nonbank financial institution (NBFI) under the Financial Institutions Act, 1993. In June 1998, the Securities and Exchange Commission granted the company a license to operate as a full-fledged merchant banker. The company's leasing, term financing, housing finance, and merchant banking operations are complementary to SMEs. Corporate governance practices are yet to be standardized, and delegation of authority in Bay Leasing and Investment is limited. As for credit risk management, the practice requires strengthening. CRAB assigned BBB2 rating in the long term and ST-4 rating in the short term. Financial performance has been improving in recent years.

7. **Dhaka Bank.** Dhaka Bank has the legal and institutional prerequisites to establish its initial eligibility. It is a private sector commercial bank focusing on corporate banking, retail banking, SME banking, and Islamic banking. The board functions relatively effectively. There is an independent director to provide impartial oversight of the management performance. Delegation of power is adequate. Dhaka Bank has adequate SME sector lending exposure. Its corporate and commercial loan portfolio includes potential SME sectors such as textile and garments, real estate, trading, and manufacturing. Dhaka Bank also utilized technical assistance from the World Bank and other development agencies for continuous improvements in its SME products and services. Dhaka Bank continuously builds its network with a total of 44 branches and potentially expanded SME outreach capacity. There is appropriate mechanism to cover credit, market, operations, and compliance risks. CRISL assigned it an A+ rating in the long term and ST-2 in the short term as of March 2009. The financial performance of Dhaka Bank remained satisfactory.

8. **Eastern Bank.** Eastern Bank has the legal and institutional prerequisites to establish its initial eligibility. It is a private commercial bank and provides a wide range of financial products including SME banking. The overall corporate governance practice is conducive to the business
operations. Delegation of power has been improving form 2007. Eastern Bank also launched some new SME products in 2007. Both loan and deposit products are tailored toward SMEs. Eastern Bank's credit risk management is in line with the prudential guidelines set by Bangladesh Bank. CRISL upgraded Eastern Bank's rating from A to A+ in the long term and maintains its ST-3 rating in the short term for 2008.

9. **Fidelity Assets and Securities.** Fidelity Assets and Securities has the legal and institutional prerequisites to establish its initial eligibility. It is a public limited company and obtained its NBFI license from Bangladesh Bank in 2001. Major business sectors include transport finance, women enterprises, SME finance, term loans for manufacturing, and merchant banking. The company's market share is small and corporate governance is limited. There is still no audit committee, and an internal audit or compliance function is absent. Delegation of authority in the company is also limited. Although the current business pipeline is adequate, the company relies largely on a single (transport) sector and this imposes risk. The risk management practice needs improvement, but various implicit guarantees and support from sponsors and clients reduce the overall risk exposure. CRAB assigned it a BBB2 rating in the long term and an ST-3 rating in the short term. Financial performance is acceptable. The company's average efficiency ratio in 2003–2005 was high at 26.8% (compared with the peer average of 17.6%).

10. **GSP Finance (Bangladesh)**. GSP Finance has the legal and institutional prerequisites to establish its initial eligibility. It is a joint venture NBFI and obtained its license from Bangladesh Bank. Corporate governance in the company is adequate. Delegation of power is sufficient. The company's primary sector exposure is in textile, transport, education, and services. Overall risk management is satisfactory. The company fulfilled Bangladesh Bank requirements in terms of paid-up capital, statutory reserve, and general reserve. CRAB assigned it an A2 rating in the long term and ST-2 rating in the short term. The profitability of GSP Finance has been declining over 2002–2006, mainly from the deteriorating revenue in merchant banking.

11. **Industrial Development Leasing Company of Bangladesh.** Industrial Development Leasing Company meets most pre-identification conditions for PFI eligibility. A joint venture NBFI, it is the first leasing company in Bangladesh and the largest and most diversified NBFI of the country. Corporate governance supports business operations and shareholder rights. Delegation of power is adequate. There is a specialized SME division within the company. In addition to good credit risk management, the company has strong oversight on operational risk and market risk, including asset and liability management, internal control and compliance, recovery and marketing, and audit. CRAB rated the company AA2 in the long term and ST-1 in the short term. Compared with the NBFI average, the company is performing better in terms of growth patterns of loan disbursement, recovery, loan outstanding, and overdue trend.

12. **Industrial and Infrastructure Development Finance.** Industrial and Infrastructure Development Finance meets most pre-identification conditions for PFI eligibility. The company is a private sector financial institution. It provides term financing to industrial businesses and infrastructure projects and leasing for all types of machinery and equipment. It also provides structured finance, equity financing, and SME financing. The company was sponsored by some leading private and public sector banks and financial institutions. As a result, it has an advantage in tapping into the resources of its promoters. Corporate governance is adequate and it has a designated SME department. Risk management is strong. CRAB assigned the company AA3 for the long term equity rating and ST-2 for the short term, as of April 2008. In 2007, the company outperformed industry average for most of the growth indicators including loan and advance growth, disbursement, total assets, and deposit growth.
13. **International Leasing and Financial Services.** International Leasing and Financial Services has the legal and institutional prerequisites to establish its initial eligibility. It obtained the license from Bangladesh Bank with an authorized capital of Tk300 million. The credit portfolio includes leasing, term finance, work-order finance, factoring, project finance, syndication, and capital market activities. The company's clients are largely medium-sized to large enterprises. The company is yet to form its SME product line. Corporate governance is adequate, despite being a closely held public limited company. The management committee lacks certain financial authority. The company operates without sufficient credit risk management tools, but follows specific policies and guidelines for credit risk management. The credit portfolio is diversified into different sectors. CRISL maintained its A− rating in the long term and ST-3 rating in the short term as of April 2007, with a negative outlook. The company's financial performance is average compared to its peers, and its operating efficiency was below the peer median.

14. **Islamic Finance and Investment.** Islamic Finance and Investment might not have the legal and institutional prerequisites to establish its initial eligibility. It obtained its license from Bangladesh Bank as an NBFI and it is the only NBFI in the country operating under the principle of Islamic Shariah. It is a closely held public limited company by 23 business sponsors. There is some delegation of power. There is a clear commitment from the company to enter the SME sector and to do so through an extended network. However, additional effort is required to enter areas outside the metropolitan areas of Dhaka and Chittagong. The company has been operating without a proper structured credit risk management environment. In addition to weak credit risk management, the company has limited operational and market risk management practice. The CRISL 2005 rating is BB in long term and ST-4 in short term. The company is an average performing NBFI in its peer group and is deemed below investment grade.

15. **Mercantile Bank.** Mercantile Bank has the legal and institutional prerequisites to establish its initial eligibility. It is a commercial bank established as a public limited company and listed on the Dhaka Stock Exchange and Chittagong Stock Exchange from 2004. The lending portfolio includes trading, garments, housing, contractor finance, food and beverages, engineering, textile, agriculture, transport, and other major industries. There is proper sector exposure in SME-related areas. Corporate governance practice is acceptable, and the board delegated the loan approval authority to the credit committee. SME commitment is strong and there are three designated SME centers. Risk management practice is acceptable, but it is yet to implement Basel capital adequacy requirements. CRISL upgraded Mercantile Bank from A− in 2007 to A in 2008 in the long term and from ST-3 to ST-2 in the short term. Profitability improved from 2006 to 2007.

16. **MIDAS Financing.** MIDAS Financing has the legal and institutional prerequisites to establish its initial eligibility. It is an NBFI and a nongovernment organization that provides technical and financial assistance to micro and small enterprises. The company obtained its license from Bangladesh Bank. The initial paid-up capital was Tk55.40 million. Corporate governance is adequate, but there is no audit committee or any other supervisory committees to oversee internal control issues. The delegation of power is appropriate and the managing director has full authority in running the day-to-day business. The company has the required commitment and capacity in supporting small enterprise finance. The company follows a structured guideline for the credit appraisal and approval process, and risk management is adequate. As of December 2004, CRISL rated MIDAS Financing BBB in the long term and ST-3 in the short term. Although the overall performance improved, the net profit margin dropped from 20.98% in FY2003 to 15.6% in FY2004. This was still above the peer average.
17. National Credit and Commerce Bank. National Credit and Commerce Bank has the legal and institutional prerequisites to establish its initial eligibility. It is a full fledged private commercial bank and provides various financial products to a wide range of industry sectors. There is a lack of detailed corporate governance information. The company has a SME financing function, as well as exposure in the garments, textile, steel and engineering, financial, insurance, electronics, and cement and construction sectors. There are close to 60 branches. The overall risk management practice has been improving over time, as reflected by the improving credit rating. The capital adequacy ratio improved from 8.01% in 2002 to 9.78% in 2006. However, asset quality is still a concern. CRAB has upgraded its long term rating from A3 to A2 and retained the short term rating ST-3 as of June 2008. Financial performance improved slightly from 2006 to 2007.

18. One Bank. One Bank has the legal and institutional prerequisites to establish its initial eligibility. It is a private commercial bank. The clientele includes reputable businesses in trading, manufacturing, and services in various sectors of the economy. The company held the initial public offering in June 2003 and raised about Tk600 million in capital. There is a concentration of ownership, and the rights and equitable treatment of shareholders needs improvement. The delegation of power is limited. The company focuses largely on financing medium-sized to large enterprises of working capital loans and long-term financing, and has limited operation in small enterprise lending. Risk management and loan pricing are designed to reflect risk-based lending. The 2006 and 2007 ratings by CRISL are A in the long term and ST-3 and ST-2 in short term, with a positive outlook. The financial performance of the company was satisfactory comparing to its peers.

19. People's Leasing and Financial Services. People's Leasing and Financial Services has the legal and institutional prerequisites to establish its initial eligibility. It is an NBFI listed on both the Dhaka and Chittagong stock exchanges since 2005. Its lending portfolio includes ready-made garments, food and allied products, services and entertainment, telecommunication, pharmaceuticals, and textile. The exposure to SME sectors is adequate, and the company offers SME financing. Bangladesh Bank found that the company's corporate governance practice is moderate. The credit risk management tools in the company are weak. The company has no written credit policy or manual specifying lease and credit appraisal and approval process, and it is yet to formulate a separate credit policy with guidelines for sector exposure and single client limits. CRAB assigned the company A3 in the long term and ST-3 in the short term. The company performance is satisfactory.

20. Premier Leasing and Finance. Premier Leasing and Finance has the legal and institutional prerequisites to establish its initial eligibility. It was incorporated as a public limited company, and sponsored by a diverse group of businesses. There is a concentration of ownership: 63.76% of the shares are held by 21 sponsors. The board has delegated only certain authorities to the management. The company's SME commitment needs strengthening. There is no clearly designated SME division. Preferential treatment for reputable businesses is a disadvantage for SMEs. There is still no separation of the credit marketing, analysis, and administration functions. The company is yet to adopt a credit risk grading system at the pre-sanction stage to ensure transparency. CRISL assigned a BBB rating to the company in the long term and ST-3 in the short term. The company's financial performance is moderate as compared to its peers.

21. Premier Bank. Premier Bank has the legal and institutional prerequisites to establish its initial eligibility. It is a private commercial bank and was issued a banking license by Bangladesh Bank in 1999. The company operates on both conventional and islamic banking. The company went public in 2007 and is now listed on both Dhaka and Chittagong stock exchanges.
Corporate governance is adequate, and there are sufficient checks and balances between the board and management. There are seven rural branches that could potentially assist SME finance in nonurban areas. Risk management is appropriate but additional risk exposures exist for Shariah-based lending operations. CRISL upgraded the company from BBB+ in 2007 to A– in 2008 in the long term and maintained the ST-3 rating in the short term. The overall financial performance improved in 2008.

22. **Prime Bank.** Prime Bank is a highly acclaimed private commercial bank and it meets most pre-identification conditions for PFI eligibility. It is a publicly listed bank registered with both Dhaka and Chittagong stock exchanges. It has grown both horizontally and vertically. Prime Bank’s board function is effective. The board has delegated all administrative power, and required financial and business powers to management. Prime Bank offers a wide range of conventional and Islamic products and services, including SME finance. It has the commitment and strong capacity to cater the SME sector. Risk management is thorough and comprehensive. CRISL maintained its AA rating in the long term and ST-2 in the short term as of June 2008. Prime Bank’s performance is satisfactory among the competing banks and is above average in terms of the banking sector as a whole.

23. **Trust Bank.** Trust Bank has the legal and institutional prerequisites to establish its initial eligibility. It obtained a license from Bangladesh Bank in 1999. Army Welfare Trust of the Bangladesh Army is the major shareholder. Trust Bank offers a full range of commercial banking services, including SME finance. In terms of corporate governance, ownership was highly concentrated until recently. Delegation of power is appropriate. The relatively extensive branch network is sufficient to provide some SME outreaches. Trust Bank adopted the best-practice guideline suggested by Bangladesh Bank and it has a written credit policy manual. CRISL assigns A to Trust Bank in the long term and ST-2 rating in the short term as of 2007. Trust Bank’s performance was average during 2007 compared to its peers. The operating efficiency is satisfactory.

24. **United Leasing.** United Leasing has the legal and institutional prerequisites to establish its initial eligibility. It is an NBFI sponsored by institutions including ADB. United Leasing expanded its credit products from leasing and term finance to working capital financing, bill discounting, and factoring. The term loan products cater the SME sector by offering collateral free long-term loans. Corporate governance practice is adequate, and there is proper delegation of authority. United Leasing has sufficient credit risk management tools. CRISL assigned an A+ rating to United Leasing in the long term and ST-3 in the short term as of May 2008. Revenue from 2004 to 2008 has improved substantially, but return on equity dropped from 23% to 14% and earning per share remained at the same level.

25. **Uttara Finance and Investment.** Uttara Finance and Investment provides lease finance, term finance, SME finance, and merchant banking services. It was incorporated as a public limited company with an authorized capital of Tk1,000 million and paid-up capital of Tk316.80 million. The company was registered with the Securities and Exchange Commission as a merchant bank in 1998. In terms of corporate governance practice, the company’s share holding is highly concentrated, with a few large shareholders. There is an independent director on the board, and delegation of authority is adequate. The company has the needed SME sector exposure, and a designated senior relationship manager that deals with SME clients. The company still follows the conventional credit appraisal, although Bangladesh Bank advised a system-based approach, and the process needs improvement. CRISL assigned an A+ rating to Uttara Finance and Investment in the long term and ST-3 in the short term as of June 2008. The profitability-related indicators showed satisfactory performance in 2007.
Appendix 7

TECHNICAL ASSISTANCE SUBPROJECT FOR PROMOTING WOMEN’S ENTREPRENEURSHIP

A. Introduction

1. Women in Bangladesh are a significant entrepreneurial force, contributing to the development of local, national, and global economies. Women-run businesses—mostly micro and small enterprises—are found in the production and marketing of agricultural and consumer goods, as well as the provision of services for local, national, and multinational markets.

B. Impact and Outcome

2. In this context, the impact of the technical assistance subproject will be the development of women’s micro, small, and medium-sized entrepreneurship in the TA subproject area. The outcome will be enhanced capacity of women entrepreneurs and associations to fully access the financial resources and services earmarked for women’s small and medium-sized enterprises (SMEs) under the Asian Development Bank (ADB) loan. The TA subproject will be implemented in selected zilla (districts) identified at the TA subproject onset based on a set of agreed criteria.

C. Outputs

3. Output 1: Constraints and Opportunities for Women Entrepreneurship Identified. The Subproject will collect relevant baseline information and data on the factors that enable women to, or constrain them from, becoming effective entrepreneurs in selected industries known for women’s involvement. Information will be collected from existing literature in the TA subproject area and through consultation with government, civil society, existing male and female entrepreneurs, and private sector stakeholders. This will involve gathering baseline and other information on (i) women-led businesses (i.e., micro, small, and medium-sized enterprises; self-help groups; cooperatives; and NGOs); (ii) different needs and constraints faced by women entrepreneurs at different stages of enterprise evolution and for different trades; (iii) barriers to women’s access to skills and technology, market information, business services, networking, linkage and financial resources and services; and (iv) innovative and diverse approaches adopted to overcome gender-related barriers to women’s entrepreneurship in specific sectors. Training and capacity development needs assessment will be carried out in six selected districts to inform the advocacy, training, and capacity development initiatives to be supported under outputs 2 and 3 below.


   (i) Enforcement of gender-responsive regulations. In March 2008, Bangladesh Bank issued a circular to scheduled commercial banks to promote women entrepreneurs’ access to institutional and financial facilities at easy terms and conditions. In this context, and limited to the TA subproject area, the TA subproject will (a) identify and document current practices adopted by scheduled commercial banks and nonbank financial institutions identified by Bangladesh Bank to comply with gender-responsive provisions set out by Bangladesh Bank; (b) support advocacy with selected banks and participating financial institutions (PFIs) to open women entrepreneurs’ dedicated desks and orient officers; (c) develop a gender-responsive training program in collaboration with the existing bankers’ training institutes to strengthen participating banks officers’ mind-set and skills to review proposals for funding eligibility; and (d) provide legal literacy and aid services to
women entrepreneurs and associations to address regulatory and administrative impediments in accessing financial resources and services.

(ii) **Advocacy for gender-responsive policy reform.** The component will support ongoing efforts to engage with relevant government entities and local government bodies (i.e., Bangladesh Bank, the Board of Investments, the Board of Revenues, Ministry of Commerce, Ministry of Finance, Ministry of Industry, the Bangladesh Small and Cottage Industries Corporation, the SME Foundation, and city corporations and municipalities) and advocate for gender-responsive policy and legal and regulatory reforms to ensure women’s greater representation in SME decision-making processes and structures and women entrepreneurs’ equal access to financial resources, business opportunities, infrastructure, and services.

5. **Output 3: Technical Capacity of Selected Women Entrepreneurs and Associations Strengthened.** Women usually prefer to undertake new activities that challenge traditional attitudes in groups to overcome resistance together and to build their confidence with mentoring from women with greater public experience. In the selected districts, the TA subproject will support 2-year entrepreneurship development and business management training—targeting the needs and constraints faced by women entrepreneurs’ organizations and networks (output 1) in selected subsectors. They will include (i) development of women’s entrepreneurs; (ii) micro and small business planning (including demand, cost–benefit, and risk analysis), business management (including bookkeeping, accounting, and financial management), and marketing planning and strategy; (iii) preparation of technical and financial proposals; (iv) access to market and product information (suppliers, export opportunities, pricing information, product styles, equipment and information technology value chain and product development cycle for selected trades); and (v) marketing techniques. Exposure visits, trade fairs, and lateral learning will be encouraged. Support may be provided to operationalize and utilize the SME help-line in selected areas.

6. **Output 4: Dissemination of Findings and Identification of Follow-Up Initiatives.** Findings and lessons from the supported initiatives targeting rural women will be presented at several meetings, including a high-level national conference with the participation of Bangladesh Bank, the Federation of Bangladesh Chambers of Commerce and Industry, the Bangladesh Women Chamber of Commerce and Industry, the Chittagong Women Chamber of Commerce and Industry, the Bangladesh Federation of Women Entrepreneurs, the Women Entrepreneurs Association of Bangladesh, the SME Foundation, the Bangladesh Small and Cottage Industries Corporation, representatives of public and private banks and financial institutions (including Micro Industries Development Assistance and Service), and the media. Relevant TA subproject findings will be disseminated through relevant government, civil society, and private sector networks.

D. **Project Evaluation and Information Dissemination**

7. The TA subproject will be implemented over 36 months, commencing in September 2009 with completion expected in September 2012. A midterm review will be held in Dhaka to assess progress in implementation of the proposed activities and to adopt corrective actions—as needed—to ensure timely and effective implementation of the TA subproject activities and the effective targeting of women entrepreneurs. A final meeting will be held in Dhaka to present TA subproject findings and recommendations and to identify modalities to incorporate these into DMCs’ policies, strategies, and programs, and the ADB loan portfolio. Consultations at the zilla (district) and upazila (subdistrict) level will be complemented by national consultations at critical stages of TA subproject implementation.
FUNDS FLOW CHART

ADB

Government of Bangladesh

Bangladesh Bank

PFI

SMEs outside the metropolitan areas of Dhaka and Chittagong

ADB

ADF

• 1% during grace period, and 1.5% thereafter
• 32 years, 8 years grace

$76 million

Taka equivalent of $ million

• Bangladesh Bank Rate

• Bangladesh Bank Rate + bank spread

Source: ADB estimates.
### IMPLEMENTATION SCHEDULE AND ARRANGEMENTS

#### Table A9: Implementation Schedule

<table>
<thead>
<tr>
<th>Item</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Loan Effectiveness</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B. Small and Medium-Sized Enterprise Development Project</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. First Year Disbursement ($26.0 million)</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Second Year Disbursement ($25.0 million)</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>3. Third Year Disbursement ($25.0 million)</td>
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<tr>
<td>C. Annual Review / Midterm Review</td>
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<tr>
<td>D. ADB Review Missions</td>
<td></td>
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</tr>
</tbody>
</table>

ADB = Asian Development Bank.
Source: ADB estimates.

#### Figure A9: Implementation Arrangements

ACSPD = Agricultural Credit and Special Programs Department, PFI = participating financial institution, SMEs = small and medium-sized enterprises.
Source: ADB estimates.
### SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

<table>
<thead>
<tr>
<th>Country/Project Title:</th>
<th>Bangladesh: Small and Medium-Sized Enterprise Development Project</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lending/Financing</td>
<td>Project</td>
</tr>
<tr>
<td>Department/Division:</td>
<td>South Asia Department</td>
</tr>
<tr>
<td></td>
<td>Financial Sector, Public Management, and Trade Division</td>
</tr>
</tbody>
</table>

## I. POVERTY ANALYSIS AND STRATEGY

### A. Linkages to the National Poverty Reduction Strategy and Country Partnership Strategy

In Bangladesh, micro, small, and medium-sized enterprises account for about 80% of industrial employment and have the potential to create employment opportunities for the rural labor force. Small and medium-sized enterprises (SMEs), through backward and forward linkages, can support higher productivity of the larger industries and boost the rural economy by absorbing a large proportion of the rural unemployed labor force. Bangladesh’s National Strategy for Accelerated Poverty Reduction II (FY2009–2011) (NSPR) aims to raise private investment and savings—improving economic growth rates for poverty reduction and accelerating the pace of social development. For this, the NSPR supports the preparation of a strategic vision for private sector development, provision of institutional finance, strengthening of capital markets, and development of SMEs. The financial needs of SMEs and the issues related to the financial constraints faced by women entrepreneurs are clearly stated in the NSPR. Promoting women’s entrepreneurship, and providing business support services and market support are envisaged as means to boost the SME sector and contribute to poverty reduction. Supporting SME development is crucial during the current global economic crisis. There are indications that the global financial crisis is beginning to affect Bangladesh’s economy through slower growth in export earnings and remittances, which is reflected through rising job losses and the return of Bangladesh’s migrant laborers. In this context, promoting easier access to finance for SMEs is critical to promote economic growth and social protection. The country partnership strategy for Bangladesh (2006–2010) aims to address the significant demand for financial services in coordination with other development partners, mainly the International Monetary Fund and the World Bank. Improved access to finance and capacity development of financial intermediaries in the SME sector, through the loan project and associated technical assistance (TA), will support the country partnership strategy outcomes, i.e., higher productivity, employment, and income generation, leading to poverty reduction.

### B. Poverty Analysis

#### 1. Key Issues

In Bangladesh, the SME sector accounts for 25% of the gross domestic product (GDP) and provides more than 75% employment. A vibrant SME sector is important for investment, growth, and employment generation, especially in the context of the current economic slowdown. Enhanced availability of credit, particularly for sectors prioritized by national industrial policy for increasing employment and exports (especially SMEs located in the nonurban and rural areas), is essential as it can support poverty reduction by creating employment opportunities for local people. Women entrepreneurs, who are generally engaged in microenterprises and lack access to capital, need to be supported. Support for a credit line targeted at SMEs will indirectly contribute to poverty reduction. The Project will address this important need, as envisaged in the NSPR. The direct beneficiaries of the Project will be SMEs, which—through financial intermediaries—will have access to capital.

#### 2. Design Features

Pro-poor sustainable economic growth is to be achieved through the Project’s focus on measures to improve SME economic growth and development, especially in nonurban and rural areas, where the incidence of poverty is high. In addition, by ensuring availability of finance, more entrepreneurs—including women—will be able to expand their enterprises, establish new SMEs, or expand existing SMEs. This will create employment opportunities for entrepreneurs, employees, as well as laborers (skilled and unskilled), thereby contributing to social development and poverty reduction.

## II. SOCIAL ANALYSIS AND STRATEGY

### A. Findings of Social Analysis

In Bangladesh, industrial development is driven by the SME sector which is integral to accelerate economic growth and generate employment thereby leading to poverty reduction. A large proportion of the population, including microfinance graduates and educated youth, are dependent on SMEs. Entrepreneurs in this sector face various constraints, including (i) lack of medium- and long-term credit, as most of the credit is short-term; (ii) the requirement of collateral and guarantee (entrepreneurs often do not have sufficient assets, such as land, for collateral); (iii) high transaction cost and limited credit information, which discourages entrepreneurs to access institutional credit; (iv) limited connectivity to markets because of lack of information and linkages; (v) lack of infrastructure and utilities, especially uninterrupted energy supply; (vi) complexities related to tax and tariff measures; (vii) low capacity of chambers and business associations in providing guarantee and capacity building support; and (viii) low business management capacity of entrepreneurs.
The beneficiaries need access to medium- and long-term credit; business development services; connectivity to markets and market linkages; infrastructure and utility services (especially energy, transport, telecommunications, technology, and business information); and simplification of procedures to access institutional finance for SMEs. Availability of finance is considered the prime need, as most of the people have limited resources for investment. The Project will support enhancing credit delivery for SMEs, especially in nonurban and rural areas, with a minimum quota provision for allocation to women entrepreneurs; and by extending information and other capacity development support to women entrepreneurs to access finance and business development.

### B. Consultation and Participation

1. Provide a summary of the consultation and participation process during the project preparation.

The Project was prepared in consultation with a broad range of stakeholders, including Bangladesh Bank, the Board of Investment, the National Board of Revenue, Ministry of Commerce, Ministry of Finance, Ministry of Industry, the Bangladesh Small and Cottage Industries Corporation (BSCIC), the SME Foundation, city corporations and municipalities, various private sector agencies (including chambers of commerce and business associations), and development partners. In addition, in-depth consultations were carried out with the Bangladesh Women Chamber of Commerce and Industry (BWCCI), the Women Entrepreneurs Association, and Micro Enterprise Development Assistance and Services (MIDAS). The findings and recommendations of these discussions resulted in the identified need for capacity development initiatives targeting the specific needs and constraints faced by women entrepreneurs (Appendix 7).

2. What level of consultation and participation (C&P) is envisaged during the project implementation and monitoring?

- [ ] Information sharing  
- [x] Consultation  
- [ ] Collaborative decision making  
- [ ] Empowerment

3. Was a C&P plan prepared?  
- [x] Yes  
- [ ] No

### C. Gender and Development

#### 1. Key Issues.

Women in Bangladesh are a significant entrepreneurial force, contributing to the development of local, national, and global economies. Women-run businesses—mostly micro and small enterprises—are found in the production and marketing of agricultural and consumer goods, as well as the provision of services for local, national, and international markets. Enterprises owned by women feature some interesting characteristics regarding ownership, management, sources of capital, technology, market orientation. More specifically:

- **Ownership.** Most of the enterprises are owned individually and some are partnerships. Partners are mainly family members and friends. Larger undertakings requiring capital from banks are formed into companies mostly through the synergy of family members. Available gender-disaggregated data suggest that only a very small percentage of the total number of enterprises are owned by women entrepreneurs or jointly owned by men and women. Women’s partnerships are often established in larger ventures to protect family property without having meaningful involvement or control over the assets. Very few companies have female board members. A small percentage of women borrowers access loans from a selected number of banks, and that too jointly with male relatives unless there is a specific program to lend to women for business purposes. In recent years, encouraging trends suggest women’s increasing role as sole proprietors and increasing access to institutional finance.

- **Decision making and management.** Decisions related to choice of enterprise and market and borrowings are mostly done by the owner. For large endeavors, maintaining family control is also practiced. In many cases, the decisions are taken by the male family members or according to their guidance. Two management styles are visible: (i) the owner is the manager and all the major decisions in all areas are taken by the owner; (ii) the owner is the manager but market and bank-related activities are supported and influenced by male relatives. The owner and manager is the source of all information and skills, including finance, market, and technology. For large undertakings, management and production technology may be hired externally. In recent years, encouraging trends suggest women’s increasing involvement in market and bank-related activities.

- **Market.** Most women-owned enterprises produce or provide services for domestic markets directly to consumers or retail sellers. Often, the production and market are seasonal. Large enterprises sell to wholesalers and, depending on the product, aim for foreign markets. Export is mostly in the area of handicrafts and agro-based products (including processed food items, jute goods, glassware, and leather products). The quality and price of raw materials vary, small purchases limit the bargaining power; as a result, prices are high. Imported items are purchased through importers; as such, the importers receive the benefits of any incentive in the tariff structure or protection. Most of the enterprises do not have backward or forward linkages or are not in any subcontracting arrangements.

2. **Key Actions.** Measures included in the design to promote gender equality and women’s empowerment—access to and use of relevant services, resources, assets, or opportunities and participation in decision-making process:

- [x] Gender plan  
- [ ] Other actions/measures  
- [ ] No action/measure
The gender action plan summarizes relevant gender design features of the loan, and reports on how women are to be involved in the design, implementation, and monitoring process. Gender design features include (i) earmarked resources, under the Project’s credit line, whereby a minimum of 15% of the funds are allocated for lending to qualified female entrepreneurs; and (ii) capacity development initiatives carried out under grant-financed TA subproject to strengthen the ability of women entrepreneurs to avail of opportunities provided under the loan. In this context, the impact of the proposed activities will be the development of women’s micro-, small and medium-sized entrepreneurship in the TA subproject area. The outcome will be enhanced capacity of women entrepreneurs and associations to fully access the financial resources and services earmarked for women’s SMEs under the ADB loan. More specifically, the TA subproject will (i) help assess constraints and opportunities to women entrepreneurs’ effective access to financial resources made available under the loan; (ii) support the financial and legal literacy of women entrepreneurs and associations; (iii) enhance women entrepreneurs’ managerial capacity, technical skills, productivity, and competitiveness; and (iv) promote networking among women entrepreneurs’ associations and forward and backward linkage industries. The TA subproject will be implemented in selected zilla (districts) identified at subproject onset, based on a set of agreed criteria. All gender-relevant activities will be implemented by BWCCI in consultation with the Government (Finance Division of the Ministry of Finance), Bangladesh Bank, and other relevant partners (BSCIC, the Bangladesh Industrial Technical Assistance Centre, the Bangladesh Institute of Management, the National Productivity Organization, the Small and Cottage Industries Training Institute, and other chambers in the selected districts).

III. SOCIAL SAFEGUARD ISSUES AND OTHER SOCIAL RISKS

<table>
<thead>
<tr>
<th>Issue</th>
<th>Significant/ Limited/ No Impact</th>
<th>Strategy to Address Issue</th>
<th>Plan or Other Measures Included in Design</th>
</tr>
</thead>
<tbody>
<tr>
<td>Involuntary Resettlement</td>
<td>No impact</td>
<td>No involuntary resettlement impact from the Project</td>
<td>☒ Full Plan</td>
</tr>
<tr>
<td>Indigenous Peoples</td>
<td>No impact</td>
<td>The Project will not have any impact on indigenous peoples and ethnic minority in Bangladesh.</td>
<td>☐ Plan</td>
</tr>
<tr>
<td>Labor</td>
<td>Significant</td>
<td>The Project will increase employment opportunities in the SME sector, both for males and females. A positive impact on the labor market is foreseen. The Project will ensure close monitoring of the enterprises supported under the Project.</td>
<td>☐ Plan</td>
</tr>
<tr>
<td>Employment opportunities</td>
<td></td>
<td></td>
<td>☒ Other Action</td>
</tr>
<tr>
<td>Labor retrenchment</td>
<td></td>
<td></td>
<td>☒ Other Action</td>
</tr>
<tr>
<td>Core labor standards</td>
<td></td>
<td></td>
<td>☒ No Action</td>
</tr>
<tr>
<td>Affordability</td>
<td>No impact</td>
<td></td>
<td>☒ Action</td>
</tr>
<tr>
<td>Other Risks and/or Vulnerabilities</td>
<td>Limited</td>
<td>Risks include weak commitment to SME development and inadequate institutional coordination. The situation may be further affected by the global financial crisis.</td>
<td>☐ Plan</td>
</tr>
<tr>
<td>HIV/AIDS</td>
<td></td>
<td></td>
<td>☐ Other Action</td>
</tr>
<tr>
<td>Human trafficking</td>
<td></td>
<td></td>
<td>☐ No Action</td>
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<tr>
<td>Others</td>
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</tbody>
</table>

IV. MONITORING AND EVALUATION

Are social indicators included in the design and monitoring framework to facilitate monitoring of social development activities and/or social impacts during project implementation? ☒ Yes ☐ No

---

a Backward linkages are the interconnection of a sector to those sectors from which an SME purchases inputs; forward linkages indicate the interconnection of a sector to those sectors to which it sells output.


## GENDER ACTION PLAN

<table>
<thead>
<tr>
<th>Activities</th>
<th>Indicators and Targets</th>
<th>Responsibility</th>
<th>Time Frame</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Output 1: Constraints and Opportunities to Women’s Entrepreneurship Identified</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) A minimum of 15% of the Project’s credit line should be earmarked for women entrepreneurs.</td>
<td>Project progress report Project completion report</td>
<td>Finance Division of the Ministry of Finance in consultation with other relevant agencies.</td>
<td>Months 1–36</td>
</tr>
<tr>
<td>(ii) Collect baseline information and data on women’s entrepreneurship in selected districts on factors that enable women to, or constrain them from, becoming effective entrepreneurs in selected industries known for women’s involvement.</td>
<td>Baseline information and data collected in six selected districts Training and capacity development needs assessment (6) carried out in selected districts</td>
<td>Finance Division of the Ministry of Finance in consultation with other relevant agencies.</td>
<td>Months 1–2</td>
</tr>
<tr>
<td>(iii) Carry out training and capacity development needs assessment in selected districts to inform the advocacy, training, and capacity development initiatives supported under outputs 2 and 3.</td>
<td></td>
<td></td>
<td>Months 3–4</td>
</tr>
<tr>
<td>(iv) Identify capacity needs and knowledge gaps.</td>
<td></td>
<td></td>
<td>Months 5–6</td>
</tr>
<tr>
<td><strong>Output 2: Advocacy Initiatives for Enforcement of Gender-Responsive Regulations and Policy Reform Implemented</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advocacy for the enforcement of gender-responsive regulations</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>(i) Assess the current status of enforcement of gender-relevant provisions in Bangladesh Bank’s regulatory frameworks</td>
<td>Gender-responsive practices adopted by participating financial institutions (PFIs) (scheduled commercial banks and financial institutions) [15] documented</td>
<td>Finance Division of the Ministry of Finance in consultation with other relevant agencies.</td>
<td>Months 6–8</td>
</tr>
<tr>
<td>(ii) Document practices adopted by scheduled commercial banks and nonbank financial institutions.</td>
<td></td>
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<tr>
<td>(iii) Ensure the adequate dissemination of information on these facilities and simplified procedures by (a) identifying potential women borrowers through promotional and awareness-building campaign; (b) attract women borrowers; and (c) provide assistance in processing women’s applications (i.e., from filling up applications and other required forms to step-by-step listing of compliance requirements).</td>
<td>12 advocacy sessions carried out in PFIs 35 dedicated women entrepreneurs’ desks open at PFIs</td>
<td></td>
<td>Months 6–36</td>
</tr>
<tr>
<td>(iv) Establish dedicated women entrepreneurs’ desks in PFIs.</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>(v) Ensure PFIs (scheduled commercial banks and nonbank financial institutions) review their overall credit lending procedures and adopt simplified procedures to encourage women applicants.</td>
<td>6 training sessions carried out</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vi) Design, develop, and deliver orientation and training programs targeting PFI officials.</td>
<td>600 PFI desk officers trained including Bangladesh Bank desk officials 36 legal literacy and aid initiatives carried out</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(vii) Women entrepreneurs commit to participate actively in training activities to be conducted under the Project prior to and after disbursement.</td>
<td>360 women entrepreneurs benefited from legal literacy and aid Effective participation of women entrepreneurs (90% participation rate)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(viii) Provide legal aid and literacy services to women entrepreneurs and associations.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Advocacy for gender-responsive policy reform</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Support ongoing efforts to engage with relevant government entities and local government bodies, and advocate for gender-responsive policy and legal and regulatory reforms to ensure (i) women’s greater representation in small and medium-sized enterprise (SME) decision-making processes and structures; and</td>
<td>Three gender-responsive policy and legal and regulatory reforms initiatives supported.</td>
<td>Finance Division of the Ministry of Finance in consultation with</td>
<td>Months 6–36</td>
</tr>
</tbody>
</table>
### Activities

- (ii) Women entrepreneurs’ equal access to financial resources, business opportunities, infrastructure, and services.

### Output 3: Technical Capacity of Selected Women Entrepreneurs and Associations Strengthened

<table>
<thead>
<tr>
<th>Activities</th>
<th>Indicators and Targets</th>
<th>Responsibility</th>
<th>Time Frame</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Training programs designed, pilot-tested, and conducted on women entrepreneurship development under private–public partnership between BWCCI and the Ministry of Industry.</td>
<td>900 women entrepreneurs trained Exposure visits (5), trade fairs (5) and lateral learning events (5) carried out; SME help-line (5) supported in selected districts.</td>
<td>Finance Division of the Ministry of Finance in consultation with other relevant agencies.</td>
<td>Months 7–8 Months 9–10 Months 10–34</td>
</tr>
<tr>
<td>(ii) Gender issues integrated in the content of all training modules developed and used in loan-supported training programs.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Exposure visits and lateral learning organized.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iv) Support provided to operationalize SME help-lines in selected areas.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Output 4: Dissemination of Findings and Identification of Follow-Up Initiatives

<table>
<thead>
<tr>
<th>Activities</th>
<th>Indicators and Targets</th>
<th>Responsibility</th>
<th>Time Frame</th>
</tr>
</thead>
<tbody>
<tr>
<td>(i) Assess the results of the activities in outputs 2 and 3.</td>
<td>Relevant TA findings disseminated through relevant government, civil society and private sector networks.</td>
<td>Finance Division of the Ministry of Finance in consultation with other relevant agencies.</td>
<td>Months 35 Months 36 Months 36</td>
</tr>
<tr>
<td>(ii) Disseminate findings and lessons from technical assistance (TA) activities at national workshops, divisional seminars, advocacy meetings, exposure visits, and trade fairs.</td>
<td>National workshops (2), divisional seminars (6), advocacy meetings (60) organized; exposure visits (3) and trade fairs (3) attended.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) Plan follow-up activities.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Others

- TA staff: (i) project manager, (ii) training coordinator, (iii) policy/legal and advocacy coordinator, (iv) senior accounts officer, and (v) support staff (36 months each); and (i) monitoring and evaluation specialist, and (ii) technical advisor (6 person-months each), on an intermittent basis.

### Notes

- This is in line with the provisions set out in the recently enacted amendment to the Refinance Scheme for Women Entrepreneurs of SME (2008), raising the minimum target for earmarked resources to women entrepreneurs from 10% to 15%, 40% of which will be dedicated to small women entrepreneurs.
- These areas include (i) Ministry of Industry: review of the industrial policy to reserve industrial parks for women entrepreneurs in all divisional towns, establish a separate bank for women entrepreneurs and ensure collateral-free loans for women entrepreneurs; (ii) Ministry of Commerce: review the export policy to make it gender-friendly; ensure 25% quota for women entrepreneurs’ participation in international trade fairs, single exhibition of local products, and other market promotion activities in foreign countries, and single country trade fair; (iii) Ministry of Finance: remove or replace current guarantee requirements on commercial loans to women entrepreneurs; and (iv) Bangladesh Bank: (a) establish central and local monitoring bodies for financing of women entrepreneurs; (b) restructure the boards of public sector banks to include at least 25% women representation; (c) monitor and record lending operations on a gender-disaggregated basis; and (d) implement the provision for collateral-free access to finance from bank and other sources. (BWCCI. 2009. Women’s National Business Agenda. Dhaka.)
- Initial consultations with women entrepreneurship (2009) suggest the need for a venture capital risk management fund to increase the interest and eagerness of commercial banks to lend to women entrepreneurs.

Source: ADB estimates.
FINANCIAL MANAGEMENT ASSESSMENT

A. Executive Summary

1. The objective of the financial management assessment is to determine whether the entities implementing the project components have acceptable financial management arrangements—including procedures for making payments, accounting treatment of transactions, financial reporting, audit of financial statements, and internal control procedures—to avoid misuse or misappropriation of funds and assets. The assessment indicates that the Project is being prepared in an area of low financial management risk, as the entities that will implement the Small and Medium-Sized Enterprise Development Project have successfully undertaken (or are currently undertaking) similar lines of credit from numerous development partners (including the World Bank and Asian Development Bank [ADB]).

2. The Executing Agency (EA) for the Project will be the Finance Division of the Ministry of Finance (MOF-FD) and Bangladesh Bank will be the Implementing Agency (IA). Bangladesh Bank was deemed appropriate to administer the Project at this stage because of Bangladesh Bank’s large contribution to the Project, its ready access to information in determining the financial soundness and capabilities of participating financial institutions (PFIs) for providing credit to the small and medium-sized enterprise (SME) sector, and its function as administrator of the Credit Information Bureau, which gathers information regarding borrowers. The Project’s credit facility will be administered by well-qualified and experienced professionals in Bangladesh Bank’s Agricultural Credit and Special Programs Department (ACSPD) who have effectively managed the credit assistance loan under ADB’s ongoing SME Sector Development Program (SMESDP). The responsibility for major payments, accounting, and conduct of audit will remain with Bangladesh Bank’s ACSPD.

B. Summary Project Description and Introduction to the Financial Management Assessment

3. The Project seeks to facilitate the development of SMEs outside the metropolitan areas of Dhaka and Chittagong, with the specific objective of reducing rural poverty. The Project consists of a loan of SDR48,927,000 ($76.0 million equivalent) from ADB’s Special Funds resources for extending credit through PFIs to rural and nonurban SMEs.

4. Given the objective of the financial management assessment, the arrangements are considered acceptable if the EA and IA are capable of making timely payments as they become due, recording correctly all transactions and balances, supporting the preparation of regular and reliable financial statements, and are subject to appropriate auditing. The financial management assessment also provides stakeholders an opportunity to discuss any issues related to the proposed funds flow and financial management structure and finalize actions required to ensure sound financial management arrangements exist before loan effectiveness. The financial management and accounting questionnaire was completed with the help of the EA, IA, and PFI staff, and the final version is attached with the report.

C. Country Issues and Risks

5. The framework for public financial accountability in Bangladesh is founded on the principles of governance associated with the model inherited from the United Kingdom. This framework is widely accepted as appropriate for the country. The primary accountability institutions and organizations for financial management, control, audit, and legislative scrutiny, however, need to evolve in line with the changes in the more advanced democracies of a similar background.

D. Institutional Arrangements

6. The EA for the Project will be MOF-FD and the IA will be Bangladesh Bank. The ACSPD of Bangladesh Bank will administer the Project’s credit facility. Bangladesh Bank will regularly monitor (i) PFIs’ continued eligibility based on eligibility criteria, and (ii) eligible disbursements against estimated PFI targets to SMEs at market interest rates consistent with ADB’s financial intermediary loan policy. To ensure responsive and timely implementation, there will be review missions in accordance with the project implementation schedule set forth in Appendix 9.

7. Bangladesh Bank will be responsible for coordinating the inputs of all PFIs, including benefit and impact monitoring reports for consideration by ADB. The IA will be responsible for (i) coordinating with relevant PFIs to ensure appraisal and management of subloans; (ii) ensuring that ADB information and reporting requirements related to PFIs and subloans are met; and (iii) ensuring that all necessary submissions of accounts, related financial statements, and disbursement records are duly submitted to ADB.

E. Funds Flow Arrangements

8. The coursing of project loan funds will be undertaken through Bangladesh Bank to the eligible PFIs for rural and nonurban SME lending. Bangladesh Bank was deemed appropriate because of (i) Bangladesh Bank’s ready access to information pertaining to the continued eligibility of the PFIs, including financial soundness and capabilities of PFIs for providing credit to the SME sector; (ii) the strengthening of Bangladesh Bank’s regulatory and supervisory capacity under the World Bank’s Central Bank Strengthening Project that encompasses support for (a) Bangladesh Bank reorganization and restructuring by reforming human resources policies, outsourcing and training, and skills upgrading of audit and other departments, (b) training and technical support for the payments and securities clearing and settlements system, and (c) financial market regulation and development; (iii) Bangladesh Bank’s role in setting corporate governance standards for banks; and (iv) Bangladesh Bank’s key role through its recently introduced policies to combat money laundering and terrorist financing. Adequate safeguards are in place to ensure appropriate use of loan funds since PFIs receive project funds from Bangladesh Bank only (i) after PFIs have made disbursements to eligible SMEs, and (ii) PFIs present detailed evidence of these disbursements (subborrower name and location, disbursement amount, etc.) to Bangladesh Bank for reimbursement purposes.

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3 World Bank. 2003. Central Bank Strengthening Project. Washington, DC. This supports implementation of Bangladesh Bank’s strengthening program by providing assistance in three major areas: legal framework, reorganization and modernization, and capacity building (research department, prudential regulations and supervision functions, as well as the accounting and auditing functions).
F. Staffing Arrangements

9. Bangladesh Bank’s financial management infrastructure will be adequate to provide the requisite financial management arrangements for the Project, which will be administered by ACSPD, having effectively managed the Small Enterprise Fund under ADB’s ongoing SMESDP. The position of project director will be assigned to the general manager of ACSPD. The project director will (i) liaise with ADB, (ii) liaise with all PFIs, and (iii) be responsible for the overall supervision of the Project. The position of alternate project director will be assigned to the deputy or assistant director from ACSPD. The major responsibilities of the alternate project director will include overseeing the budgeting, accounting, and reporting of all financial transactions related to implementing the Project under the overall supervision of the project director. For the reporting of all financial transactions, the alternate project director will be assisted by the appointment of a finance officer from ACSPD. For the budgeting and accounting, the alternate project director will be assisted by the appointment of an accounts officer from ACSPD.

G. Accounting Policies and Procedures and Financial Reporting

10. Bangladesh Bank and the PFIs are adopting Bangladesh accounting standards that are primarily based on International Financial Reporting Standards. Bangladesh Bank has developed the capacity to apply International Financial Reporting Standards and to effectively supervise and oversee financial institutions through the World Bank’s ongoing Central Bank Strengthening Project. One of the components of this project is capacity building of Bangladesh Bank through strengthening (i) the prudential regulations and supervision functions, as well as (ii) the accounting and auditing functions.

11. The PFIs will have their accounts and financial statements (balance sheet, income statement, and statement of sources and applications of funds) audited annually in accordance with sound internationally accepted auditing standards by independent external auditors acceptable to ADB. The PFIs will submit, to Bangladesh Bank, to the EA, and ADB their audited accounts and financial statements not later than 6 months after the end of the fiscal year. In addition, the PFIs will submit semiannual unaudited accounts to Bangladesh Bank.

12. Through Bangladesh Bank, the EA will (i) maintain consistent records and accounts adequate to identify goods and services financed from proceeds of the Project, (ii) ensure separate accounts for each project loan, (iii) ensure accounts and related financial statements are audited annually in accordance with international accounting standards by auditors acceptable to ADB, and (iv) submit to ADB certified audited accounts and financial statements within 6 months after the end of the fiscal year.

13. The Project’s monitoring reports prepared by Bangladesh Bank based on inputs from PFIs will be provided quarterly to the EA and ADB. The reports will contain (i) description of progress made during the period; (ii) changes to the implementation schedule, if any; (iii) problems and difficulties encountered and the remedial actions taken; (iv) social, environmental, and economic impacts; (v) work to be carried out in the next period; and (vi) a summary financial account for the Project with expenditures to date. Within 3 months of the Project’s completion, the EA, through Bangladesh Bank, will furnish to ADB a project completion report containing a detailed evaluation of project design, costs, PFI performance, social and economic impacts, and other details as may be requested by ADB.
H. Information Systems

14. Since MOF-FD and Bangladesh Bank have undertaken (or are currently undertaking) similar lines of credit from numerous development partners (including ADB), the management organization and processing systems of MOF-FD and Bangladesh Bank can produce satisfactory financial reports that meet the financial reporting requirements of the Project. These systems ensure the confidentiality, integrity, and availability of the data. The staff is adequately trained to maintain the systems.

I. Audit Arrangements

15. The project accounts will also be audited by Bangladesh Bank’s internal auditor and the Office of the Comptroller and Auditor General. The audited project financial statements will be submitted to ADB within 6 months of the end of the Government’s fiscal year or such other date as ADB may agree.

J. Disbursement Arrangements

16. Bangladesh Bank, as administrator or facility manager of the Project’s credit line, will be responsible for preparing disbursement projections, collecting supporting documents, preparing withdrawal applications, and sending the latter to ADB in accordance with ADB’s Loan Disbursement Handbook (2007, as amended from time to time). Bangladesh Bank will (i) provide information to ADB on candidate PFIs, including its assessment of their eligibility for the Project’s credit line; (ii) disqualify any PFI that has become ineligible based on a semiannual review; and (iii) review utilization and repayments of subloans/subleases of PFIs. Bangladesh Bank will maintain proper accounts, procedures, and records adequate to monitor and record the progress of subprojects financed by PFIs every 6 months. Bangladesh Bank will review and report to ADB the utilization of the facility through progress reports every 3 months. The terms and conditions of the facility will be amended as necessary based on the outcome of the review in coordination with ADB to increase utilization of the fund and respond to market needs.

17. To facilitate the timely release of loan proceeds and to expedite project implementation, the Government will, immediately after the loan becomes effective, open and maintain a project imprest account with Bangladesh Bank for the Project that is also to be managed by Bangladesh Bank. The initial advance to the imprest account will be 6 months' worth of estimated expenditures or 10% of the loan amount, whichever is lower. ADB’s statement of expenditure procedure will be used to liquidate advances from the imprest accounts. The maximum individual payment permitted under the statement of expenditures procedure is $200,000 equivalent.

K. Action Plan

Table A12: Action Plan

<table>
<thead>
<tr>
<th>No.</th>
<th>Actions Required</th>
<th>Target Dates</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Ensure that adequate financial management arrangements are in place</td>
<td>Within 1 month after loan effectiveness</td>
</tr>
<tr>
<td>2.</td>
<td>Adopt and implement ADB accounting policies and procedures for the Project</td>
<td>By loan effectiveness</td>
</tr>
</tbody>
</table>

L. Financial Covenants

18. The Government, through Bangladesh Bank, shall submit audited annual financial statements of the Project to ADB no later than 6 months of the end of the fiscal period to which they relate.

M. Supervision Plan

19. To ensure responsive and timely implementation, there will be review missions in accordance with the project implementation schedule set forth in Appendix 9. There will be regular interaction between the EA, Bangladesh Bank, and ADB. Annual performance reviews will be conducted by the Government, Bangladesh Bank, and ADB. In addition, a comprehensive midterm review will be undertaken by the Government, Bangladesh Bank, and ADB about 18 months after the Project’s effectiveness that will (i) evaluate the scope, design, and implementation arrangements; (ii) assess implementation performance against project indicators; (iii) review and establish compliance with loan covenants; and (iv) identify problems and constraints and, if necessary, recommend changes in the design or implementation arrangements.

N. Conclusion and Recommendations

20. MOF-FD, Bangladesh Bank, and all PFIs have successfully undertaken (or are currently undertaking) similar lines of credit from numerous development partners (including the World Bank and ADB). As a result, the financial management capacities of the EA, Bangladesh Bank, and the PFIs are developed to a satisfactory level to ensure smooth functioning of the Project.
GOVERNANCE AND ANTICORRUPTION RISK ASSESSMENT

1. This assessment considers (i) relevant governance issues in the Small and Medium-Sized Enterprise Development Project; (ii) relevant risk analysis of the Project; (iii) controls for corruption at the sector and project levels; and (iv) recommendations on how the findings of the assessment can be incorporated into the design of the Project.

A. Governance Issues

2. Governance issues can be considered along the following lines: (i) regional inequality and small and medium-sized enterprises (SMEs), (ii) legislative and policy framework, (iii) institutional dimensions, and (iv) accountability and transparency.

3. Regional inequality and SMEs. East–west regional inequality is a major developmental challenge in Bangladesh. There is potential for SME-driven growth to correct regional disparities in specific sectors where performance has been relatively unsatisfactory in terms of quality, waste, and distribution.

4. Legislative and policy framework. The Government’s past measures for supporting regional enterprises and SMEs have focused on the Government and the relevant agencies trying to substitute the role of markets by subsidizing tax incentives or controlling interest rates and facilitating lending. The Government and the relevant agencies have also provided business support and capacity-building assistance as well as infrastructure facilities. Such a policy has been partially effective but is not sustainable on a long-term basis since the Government needs to monitor and finance support activities as well as constantly improve the program and the structures of the relevant agencies. The Government has accepted that financing of SMEs should be left to the market, with private sector engagement, whereby bankable and commercially feasible SME projects are funded and established.

5. Institutional dimensions. SMEs are institutionally weak as business enterprises because of limited production and technical capacity, inadequate market support services, small size of operation, lack of access to business information, low-quality products, limited land ownership, and lack of access to land.

6. Accountability and transparency. The accounting systems and information disclosure of SMEs will have to be improved to remove information opaqueness. Issues include weak guardians of accountability such as the comptroller and auditor general, Bangladesh Bank, Securities and Exchange Commission, and Public Service Commission that encourage impunity. The challenge is to strengthen these oversight agencies. Furthermore, limited credit information results in SMEs incurring high-cost financing.

B. Risks, Their Severity, and Risk Mitigation Measures

7. Underlying assumptions. The main assumptions in the risk analysis are that (i) the Government will stay the course in its objective and intention for SME development, (ii) the legal and institutional reforms brought about to date will be sustained in the immediate future, (iii) effective institution building and capacity development in key agencies will continue, and (iv) the Government shares the view that this assessment presents a thorough review of SME development risks.
8. **Risk specification.** The potential risks can be grouped into several categories:

(i) Legal risks include, for example, lack of legal provisions to deal with disputes on SME loans and debt recovery as well as inadequate legislation on secured transactions.

(ii) Policy risks include, among others, reluctance of private sector banks to lend to rural and nonurban SMEs since they are considered risky ventures.

(iii) Institutional risks include weak managerial and technical capacity and skills in SMEs, including reluctance of management graduates to work in rural and nonurban SMEs.

(iv) Regulatory risks include weak implementation of governance code and standards by Bangladesh Bank and other banks.

9. **Risk severity.** The risks highlighted above are not all equally severe for regional SME development and the Project. Table A13.1 provides a risk severity matrix, which gives an indication of the four types of risks based on severity.¹

### Table A13.1: Risk Severity Matrix

<table>
<thead>
<tr>
<th>Likelihood of event occurring</th>
<th>Impact</th>
<th>5</th>
<th>4</th>
<th>3</th>
<th>2</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 Very likely</td>
<td>Type I</td>
<td>Very High</td>
<td>High</td>
<td>Moderate</td>
<td>Low</td>
<td>Very Low</td>
</tr>
<tr>
<td>Weak managerial and technical capacity and skills in SMEs, including reluctance of management graduates to work in rural and nonurban SMEs</td>
<td></td>
<td>Type II</td>
<td></td>
<td>Type III</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4 Likely</td>
<td>Lack of legal provisions to deal with disputes on SME loans and debt recovery</td>
<td></td>
<td></td>
<td>SME authority not adequately institutionalized to lead SME development</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3 Moderately likely</td>
<td>Reluctance of private sector banks to lend to rural and nonurban SMEs, including investment in medium- and long-term loans, since they are considered risky ventures</td>
<td></td>
<td>SME does not capture sufficient credit below current threshold</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh Bank’s policy adversely affecting SME development</td>
<td></td>
<td>Inadequate legislation on secured transactions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Weak implementation of governance code and standards by oversight agencies</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Unlikely</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

SMEs = small and medium-sized enterprises.

¹ The degree of severity is calculated as the product of the range of likelihood of the risk occurring and the potential impact of such a risk.
10. **Proposed mitigation measures.** Some of the mitigating measures for the primary risks are in Table A13.2.

<table>
<thead>
<tr>
<th>Risk</th>
<th>Proposed Mitigation Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weak managerial and technical capacity and skills in SMEs,</td>
<td>Subcontracting with large firms for technical assistance and technology transfer</td>
</tr>
<tr>
<td>including reluctance of graduates to work in rural and nonurban</td>
<td>Further expansion of SMEs in selected strategic industries</td>
</tr>
<tr>
<td>SMEs</td>
<td></td>
</tr>
<tr>
<td>Weak capacity of banks to support development of rural and nonurban</td>
<td>With the impending capacity enhancement of the major credit rating agencies (CRAB and CRISL), SME data collection by banks will be expanded</td>
</tr>
<tr>
<td>SMEs, as well as to sustain such strategic partnership</td>
<td>Capacity building on assessing credit based on cash flows and risk management, risk-based loan pricing, and credit scoring</td>
</tr>
<tr>
<td>Reluctance of private sector banks to lend to rural and nonurban</td>
<td>With the impending enactment of the secured transactions act, banks will move towards lending based on movable property</td>
</tr>
<tr>
<td>SMEs, including investment in medium- and long-term loans, since</td>
<td></td>
</tr>
<tr>
<td>they are considered risky ventures</td>
<td></td>
</tr>
<tr>
<td>The Government’s policy on funding development of rural and nonurban</td>
<td>Collaboration between credit rating agencies and PFIs for funding development of rural and nonurban SMEs under the Project</td>
</tr>
<tr>
<td>SMEs by banks is inadequate</td>
<td></td>
</tr>
<tr>
<td>Credit information bureau does not capture credit history below</td>
<td>Development of credit scoring systems for SMEs by credit rating agencies</td>
</tr>
<tr>
<td>current threshold</td>
<td>Modernization of registry being planned</td>
</tr>
<tr>
<td>Inadequate secured transaction legislation</td>
<td>Government to enact secured transactions bill by December 2009</td>
</tr>
<tr>
<td>Lack of legal provisions to deal with disputes on SME debt recovery</td>
<td>The Money Loan Court Act’s reform to allow creditors to sell collateral without a trial is a significant step forward. Allowing for private, licensed enforcement and auction agents would significantly speed recovery of collateral.</td>
</tr>
<tr>
<td>SME Foundation and BSCIC (within, Ministry of Industries) not</td>
<td>Rules and regulations, strategies and work plans, as well as roles and responsibilities of the Ministry of Industries need to be approved and implemented</td>
</tr>
<tr>
<td>adequately institutionalized to lead SME development</td>
<td></td>
</tr>
<tr>
<td>Weak implementation of governance code by Bangladesh Bank and</td>
<td>Operationalization of corporate governance in selected PFIs in accordance with Bangladesh Bank corporate governance standards</td>
</tr>
<tr>
<td>banks</td>
<td></td>
</tr>
<tr>
<td>Bangladesh Bank ongoing policy to SME sector discontinued, adversely</td>
<td>Continuous engagement by donor agencies on the reforms</td>
</tr>
<tr>
<td>affecting SME development</td>
<td>Bangladesh Bank will monitor and supervise participating banks</td>
</tr>
</tbody>
</table>

BSCIC = Bangladesh Small and Cottage Industries Corporation, CRAB = Credit Rating Agency of Bangladesh Limited, CRISL = Credit Rating and Services Limited, PFI = participating financial institution, SMEs = small and medium-sized enterprises. 
Source: Asian Development Bank estimates.

**C. Controls for Corruption**

11. Effective adoption and implementation of Bangladesh Bank’s corporate governance measures by the participating financial institutions (PFIs) will be critical to ensure good governance and to check corrupt practices while lending to SMEs under the Project. To minimize the inherent investment risks in lending to rural and nonurban SME projects, PFIs will need to adhere to strict internal controls, checks and balances, and risk management
procedures. The regulatory and supervisory role of Bangladesh Bank over the PFIs will be equally important to ensure corruption-free business practices.

D. Recommendations

12. To enhance the design and implementation of the Project, it is recommended to
   (i) incorporate good governance and anticorruption provisions in loan assurances,
   (ii) obtain stakeholder concurrence with governance and corruption risk mitigation strategies,
   (iii) acquire information during review missions on revised structures and processes within the Project to assess progress in managing governance and corruption risks, and
   (iv) revisit this assessment at a suitable opportunity in the project period to assess how conditions may have been more (or less) favorable for effective implementation.