



PROGRAM ADMINISTRATION MEMORANDUM
ON
LOAN 2148-BAN
TO THE
PEOPLE'S REPUBLIC OF BANGLADESH
FOR THE
SMALL AND MEDIUM ENTERPRISE SECTOR DEVELOPMENT PROGRAM

This Program Administration Memorandum (PAM) provides a practical implementation manual for the SMESDP, with particular reference to the policy-based program loan.

September 2005

CURRENCY EQUIVALENTS

(as of September 2005)

Currency Unit	–	Bangladesh Taka (Tk)
Tk1.00	=	\$0.0153
\$1.00	=	Tk65.56

ABBREVIATIONS

ADB	–	Asian Development Bank
BSCIC	–	Bangladesh Small and Cottage Industries Corporation
CPCU	–	central program coordination unit
EA	–	executing agency
IA	–	implementing agency
MOF	–	Ministry of Finance
MOF-FD	–	Finance Division of Ministry of Finance
MOI	–	Ministry of Industries
NCID	–	National Council for Industrial Development
SCITI	–	Small and Cottage Industries Training Institute
SME	–	small and medium enterprise
SMESDP	–	SME Sector Development Program
TA	–	technical assistance

NOTES

- (i) The fiscal year (FY) of the Government ends on 30 June. FY before a calendar year denotes the year in which the fiscal year ends.
- (ii) In this report, "\$" refers to US dollars.

CONTENTS

- I. THE PROGRAM
 - A. Objectives and Scope
 - B. Program Components
 - 1. Establish SME Policy and Development Framework
 - 2. Establish Institutional Structure and Mechanisms to Support SME Development
 - 3. Define Government Support to SMEs and Improve SME Access to Various Services
 - C. Important Features
- II. COST ESTIMATES AND FINANCING PLAN
 - A. Adjustment Costs
 - B. Financing
- III. IMPLEMENTATION ARRANGEMENTS
 - A. Executing and Implementing Agencies
 - B. Project Management Organization
- IV. IMPLEMENTATION SCHEDULE
- V. PROCUREMENT OF GOODS
- VI. DISBURSEMENT PROCEDURES
- VII. PROGRAM MONITORING AND EVALUATION
- VIII. AUDITING REQUIREMENTS
- IX. MAJOR LOAN COVENANTS
- X. ANTICORRUPTION
- XI. KEY PERSONS INVOLVED IN THE PROGRAM

APPENDIXES

- 1. Policy Matrix
- 2. Program Implementation Schedule
- 3. List of Ineligible Imports
- 4. Withdrawal Application
- 5. Tranche Release Conditions
- 6. Sample Audit Letter

LOAN PROCESSING HISTORY

Milestones	Dates
Reconnaissance/Pre Facting Missions	14 – 27 Jul 2003 20 Sep – 6 Oct 2003
Fact Finding Mission	29 Feb –10 Mar 2004
1 st Management Review Meeting	16 Jul 2004
Appraisal Mission	06 – 22 Sep 2004
2 nd Management Review Meeting	05 Nov 2004
Loan Negotiations	20-21 Nov 2004
Board Consideration and Approval	20 Dec 2004
Loan Agreement Signing	26 Jan 2005
Loan Effectiveness	20 Jun 2005

I. PROGRAM DESCRIPTION

A. Objectives and Scope

1. The objective of Small and Medium Scale Development Program (SMESDP) is to support government efforts to foster development of the SME sector by strengthening the policy environment for SMEs and improving SMEs' access to credit and related services. This will enable the sector to attain its full potential for contributing to sustainable economic growth and, through generation of employment, the reduction in poverty.

B. Program Components

2. The Program is designed to have three policy outcomes (see Policy Matrix in Appendix 1):

- (i) Outcome 1: Establish SME Policy and Development Framework
 - (a) Declare SMEs as a priority sector under government policy
 - (b) Formulate an SME policy and development strategy
- (ii) Outcome 2: Establish Institutional Structure and Mechanisms to Support SME Development
 - (a) Set up an institutional structure and mechanisms to implement the SME policy and development framework
 - (b) Prepare an action program to support the SME development strategy
- (iii) Outcome 3: Define Government Support to SMEs, and Improve SME Access to Various Services
 - (a) Rationalize government assistance to the SME sector including the restructuring of BSCIC and other concerned agencies under MOI involved in the sector and rationalization of government direct credit assistance currently provided
 - (b) Rationalize incentive and tax structure for SMEs
 - (c) Enhance SME access to market and government services
 - (d) Enhance SME access to capacity building
 - (e) Enhance SME access to product certification and upgrade product certification system to international standard
 - (f) Develop an integrated SME database

a. Establish SME Policy and Development Framework

3. Drawing upon the work of the SME Task Force, the Government will, as part of the Program, formulate an appropriate SME policy and development framework in consultation with various stakeholders including SMEs and development partners. The Government will adopt the SME policy and development framework that will, in particular, (i) provide the justification for government assistance to the sector; (ii) map out a government development strategy to support the SME sector over the short, medium, and long term; (iii) adopt a single uniform definition of SMEs; (iv) identify areas of assistance to SMEs to enhance their access to capital, business support services, capacity building, and technology to improve their product marketability and competitiveness; (v) delineate the institutional setup to take responsibility for SME sector development; and (vi) incorporate internationally accepted market-based principles for SME development. The National Task Force on Development of SMEs submitted its report to the Government. The Economic Affairs Committee of the Cabinet approved the

recommendations in the report, except exemption of value added tax and any Government imposed duty or tax, in January-2005.. The Industrial Policy-2005 has earmarked and identified SMEs as a thrust sector for sustainable industrial development in the country. The Industrial Policy-2005 has a special chapter on SMEs. As a positive mode of poverty alleviation and sustainable industrial development in the country; the rapid expansion and positive growth of SME has also been significantly highlighted in the Poverty Reduction Strategy Paper.

b. Establish Institutional Structure and Mechanisms to Support SME Development

4. The National Council for Industrial Development (NCID), which is chaired by the Prime Minister and charged with making policy decisions under the umbrella of the 2005 Industrial Policy, will take responsibility for SME development. The NCID has a leading role in achieving the Government's objective of undertaking various development programs aimed at establishing small, medium, and heavy industries on a massive scale throughout the country and quickly resolving problems in the industrial sector. The Government has constituted an SME Advisory Panel mandated to develop an action program to support the SME development strategy. The Panel consists of representatives from MOI and other concerned ministries, industry associations, and representatives from the private sector. MOI is the designated agency for implementation of the Government's SME development strategy and has set up an SME Cell to facilitate its operationalization. The new Industrial Policy mentioned that separate SME Policy Strategies would be formulated. The SME Policy Strategies have been formulated by MOI on the basis of the recommendations of the SME National Taskforce and the SME Advisory Panel. The SME Policy Strategies, approved by the Minister of Industries in April 2005, has been published as an official document; in both Bangla and English. The SME Cell of MOI is responsible for implementation of SME Policy Strategies.

5. Over the medium term, the Government will draft and approve the memorandum and articles of association that will provide the organizational and operational framework for setting up an SME Foundation, which will have at least 50% private sector representation on the board and a chief executive officer recruited from the private sector, to assume the responsibilities for implementing the SME development strategy and action program from the SME Cell and to take over, in a phased manner, management of SME credit facilities currently directly administered by the Government.

c. Define Government Support to SMEs and Improve SME Access to Various Services

6. **Rationalize Government Assistance to the SME Sector including the Restructuring of BSCIC and Other Concerned Agencies under MOI involved in the sector and Rationalization of Government Direct Credit Assistance Currently Provided.** The Government will review the effectiveness of existing government assistance to the SME sector and the efficiency of delivery of such assistance covering various public sector agencies, particularly those under the supervision of MOI including BSCIC, SCITI, and BSTI, as well as various forms of credit assistance now being provided to the sector. The study will undertake detailed diagnostic analysis of the selected agencies' activities in terms of need, coverage and scale, impact, cost-effectiveness and sustainability, identification of restructuring alternatives, and preparation of a restructuring plan or a phaseout plan, depending on the study's findings.

7. It is envisaged that BSCIC, SCITI, and BSTI will be restructured, or replaced by more responsive institutions. In any event, restructuring or setting up an alternative institution is to be

guided by (i) a strengthened governance structure that will introduce public-private partnership with private sector representation on the board of the organization; (ii) recruitment of professionals from the private sector, particularly for key positions; (iii) commercialization of the operations by charging fees at least for cost recovery; (iv) a strengthened performance evaluation and incentive system; (v) drawing up of a strategic plan with a time-bound road map for each product or service group, e.g., market-oriented development and management of industrial estates and parks, customer-responsive training, and capacity-building services to SMEs; and (vi) strengthened transparency and accountability, based on defined performance indicators.

8. The rationalization of concerned agencies under MOI is moving forward. Staff rationalization is currently ongoing at BSCIC as part of human resource restructuring. MOI has already started the restructuring process of the headquarter and field level offices of BSCIC by giving special emphasis on human resource development, rationalization of manpower, and examination of the programme and activities of the industrial estates. Two separate high powered committees under the chairmanship of the Additional Secretary of MOI reviewed and examined the existing manpower structure of BSCIC's headquarter and field offices respectively. The first Committee recommended the reduction of manpower in the headquarters from 494 to 276. The other Committee recommended the restructuring of the field offices (64 industrial service centers and 64 industrial estate offices). The committee also recommended the reduction of the categories of industrial service centers from three to two categories. The Government (MOI) approved these recommendations in March.2004 and instructed BSCIC in November 2004 to implement the restructuring process. This includes implementation of the approved gradation list (seniority list) of the officers. BSCIC is working on the restructuring program and MOI monitors the progress. Golden handshake and voluntary retirement program have been offered to the excess manpower and Ministry of Finance (MOF) has provided funds for the purpose. For improved productivity, training/retraining will be provided. Regardless of whether BSCIC is restructured or phased out, the Government will have to replenish the employees' provident fund and cover special deposit accounts for withdrawals made to bridge BSCIC's accumulated losses.

9. SCITI is recruiting experienced staff and faculty members. An Employment Notice for 29 posts (principal, vice principal, 6 chief faculty members, 6 senior faculty members, 9 associate faculty members, and 6 assistant faculty members), indicating the minimum qualifications for each post, was endorsed by the MOI in July 2005. The Ministry of Establishments issued a Notification in June 2005 that describes procedures for regularization in the revenue budget of personnel recruited under a development project. Following this Notification for SCITI, those project personnel who were properly recruited, i.e. in accordance with government recruitment rules and procedures for the development project, and who have continuity of service and satisfactory service record, shall be inducted into regular revenue positions. Other project personnel interested in the revenue posts will have to compete in the direct recruitment competitive process prescribed under government regulations. A Departmental Promotion Committee is reviewing the SCITI teaching personnel and will recommend those to be regularized (another committee will review the administrative and non-teaching personnel). MOI has issued an order to BSCIC that the review of SCITI project personnel should be completed by end of September 2005. For faculty and non-faculty positions for which there are no qualified candidates among the project personnel, and for new positions (e.g. principal and vice principal), the posts will be advertised and candidates will be evaluated as per recruitment process. The Appointment Notice for the 5 new faculty positions — principal, vice principal, chief faculty member (research and consultancy faculty), associate faculty member (financial management faculty), and assistant faculty member (industrial management faculty) — was

submitted to the Ministry of Information on 6 September 2005 and these positions were advertised in the newspapers on 9 September 2005. SCITI will be restructured to strengthen its capacity to deliver training and capacity building services to SMEs.

10. In light of the expected passage of the Accreditation Law that will set up the Accreditation Board, which will accredit calibration and testing laboratories and certification bodies including those in the private sector, there is a need to assess BSTI's role in conducting product testing and in certification, and to carry out a study for its strategic reorientation. The Program supports efforts to restructure BSTI to make it effective to carry out its strategic role.

11. Rationalization of credit assistance will be based on an analytical review of all government-assisted credit programs and facilities for SMEs, including their scope, interest rates, terms and conditions, and implementation arrangements. These include credit programs of government ministries, agencies, and public sector banking institutions funded from the national budget, refinancing facilities of the BB, and credit programs of nationalized commercial banks and specialized financial institutions funded from their own resources. The issues of directed lending and political considerations, subsidy, and moral hazard will be examined, and, drawing on findings of the analytical review and considering international best practices, specific recommendations to make credit delivery mechanisms more effective and sustainable will be prepared. These studies will be financed by the TA loan.

12. **Rationalize Incentive and Tax Structure for SMEs.** The SME policy and development strategy will include the Government's plan to provide for a suitable incentive and tax structure for SMEs. The recommendations of the National Task Force on Development of SMEs including enhancing fiscal support to SMEs were examined by the Government (Cabinet Committee on Economic Affairs headed by Finance Minister) and some fiscal incentives have already been incorporated in both the 2005 Industrial Policy and the SME Policy Strategies. To enhance the viability of these small enterprises, tax incentives should be given during their initial stage of operations. If the Government abolishes the tax holiday scheme in the next fiscal year, a 75% income tax rebate and accelerated depreciation allowance for plant and machinery will be given as a substitute to newly established small enterprises with fixed investments excluding land and building of less than Tk3 million. However, these tax incentives will not be provided to those enterprises that already take advantage of tax incentives under existing export incentive schemes. The Government will implement the tax incentives agreed upon to take effect from assessment year FY2006, as provided for in the Finance Act 2005 or other appropriate legislation. The impact of these tax incentives will be minimal initially because these enterprises are very small. However, in the long run, these measures are expected to facilitate the expansion of SMEs and consequently enhance revenue to the Government as they come out of the informal sector and are captured in the tax net. As stated in the Industrial Policy, to encourage the establishment of small firms, assistance will be given by way of rearranging the tax structure such that taxes and duties are fixed at the lowest level that can be justified.

13. **Enhance SME Access to Market and Government Services.** MOI has a program to implement E-governance, which will involve the development and maintenance of a web site to be linked to the web sites of other line ministries, and has constituted an e-governance committee to spearhead and coordinate this program. In November 2004, MOI constituted an E-Governance Implementation Committee with a Joint Secretary of the MOI as chairman. A roadmap of short and long term programs for introducing a national E-governance system and IT-based administration has been prepared by the Ministry of Establishment. Accordingly, the E-Governance Implementation Committee in MOI will introduce IT systems, website, internet, networking, etc. in the Ministry within shortest possible time. The Program incorporates the

development of an SME web portal/virtual front office and the establishment of SME helpline outreach centers to provide (i) assistance for facilitating access to government services; (ii) guidance to comply with government requirements including registration, product testing and certification; and (iii) dissemination of information about SMEs, market opportunities, and linkages to international markets. The terms of reference of the E-Governance Implementation Committee include assistance to the SME Cell in establishing web-portal and helpline outreach centers in the 64 administrative districts of the BSCIC field offices. The SME Cell has recently launched its website. Online registration of SMEs using this website has started. The SME Cell website will be linked to the SME web-portal to be developed and implemented. The introduction of IT systems and networking and access to internet will facilitate the operations of the helpline centers in the BSCIC field offices. The extensive geographical presence of BSCIC and FBCCI and its member associations could be used to further extend the outreach of government services to SMEs countrywide. MOI, in partnership with FBCCI and its district chambers and line associations, will establish helpline outreach centers at selected district offices of BSCIC, and knowledge centers at the Dhaka and Chittagong chambers of commerce and industry. The helpline and knowledge centers will utilize the SME web portal to provide access to information by SMEs in various parts of the country and through the Internet. Assistance for the development of the SME web portal and helpline outreach centers will be financed under the TA loan.

14. Enhance SME Access to Capacity Building. Under SMESDP, SCITI will undertake a training needs assessment and develop appropriate training programs under a public-private partnership with FBCCI, district chambers and line associations of FBCCI, accredited women entrepreneurs' associations, and the National Association of Small and Cottage Industries of Bangladesh. In November 2004 a Training Needs Assessment Committee was constituted in the MOI with a Joint Secretary of MOI as its chairman. The Committee prepared two sets of Need Assessment Questionnaire for conducting sample survey on training needs assessment of BSCIC, SCITI, stakeholders and other related training of SMEs. The Committee has drafted its initial report, which after finalization, will be submitted to the convener of the Committee (Joint Secretary, SME Cell, MOI), for endorsement to Secretary, MOI. The Government has committed to support targeted SME training, particularly for (i) SMEs in rural areas, (ii) women entrepreneurs, (iii) displaced workers in the RMG industry, and (iv) SME credit staff of participating financial institutions (PFIs) under SEF. MOI will present a plan to restructure SCITI to strengthen its capacity to deliver training services to SMEs. SCITI will charge for at least cost recovery for those who can afford to pay for the services. The TA loan will provide assistance to SCITI in implementing these training and capacity-building programs.

15. Enhance SME Access to Product Certification and Upgrade Product Certification System to International Standard. To meet SMEs' need for credible certification bodies where they can obtain a technical evaluation of the quality of their products, BSTI will be strengthened in conducting product testing and certification. The Program will also support enactment of the draft Accreditation Law, establishment of the Accreditation Board, and an application by the Accreditation Board for membership of the International Accreditation Forum to ensure worldwide acceptance of certificates issued by accredited certification bodies in Bangladesh. A draft Accreditation Law has been prepared and approved in principle by the Government. To facilitate SME access, BSTI opened in March 2005 a special desk for issuance of certification marks license to SME products. The TA loan will extend assistance in upgrading the product certification system and in promoting product certification among SMEs.

16. Develop an Integrated SME Database. For monitoring SME performance and development, and for targeting assistance, it is essential to have a database that indicates,

among other things, the number of SMEs, their characteristics and economic activities, and type and number of employees. An initial listing of SMEs will be generated from the Economic Census supplemented by other sources. This will serve as a sampling frame for large-scale nationwide sample surveys on attributes of SMEs such as employment (with gender breakdown) and output. Such data will be captured in an integrated SME database that will facilitate assessment, particularly as regards impact and effectiveness of government policies. The Bangladesh Bureau of Statistics (BBS) has completed the processing of the Economic Census and has published a preliminary report. It is envisaged that the creation of the SME database will be a collaborative effort with BBS. While BBS continues to prepare the basic statistics regarding the enterprise sector, it is important to have a dedicated unit or institution focusing on information gathering for SMEs. The SME Cell will assume this function. The TA loan will provide assistance in the development of the database.

C. Important Features

17. Rationale for Sector Development Program Modality. The sector development program modality will enable ADB to apply a holistic approach to SME development. Due to market failures, targeted policy interventions are necessary to create an enabling environment for SME development. The SMESDP policy actions will represent the key and core measures under the SME policy and development framework that will provide justification for the government interventions in the sector and help relevant agencies to focus on SME development in an integrated fashion as opposed to past ad hoc interventions. Moreover, the program loan component will provide budgetary support for the establishment of an institutional framework dedicated to SME development on a sustainable basis and for the development of support infrastructure to facilitate SME access to market opportunities, technology, business support services, government services, and capacity building. The project loan that provides funds for SEF will improve SME access to credit and will be complementary to the ongoing projects of ADB and other development partners in the financial sector. The TA loan will support implementation of policy actions, and help carry out the needed assessments, capacity building, and development of infrastructure for SMEs.

18. Complementarities to Government Initiatives and Development Agency Interventions. SMESDP underpins the Government's agenda of developing the country's private sector, particularly the SME sector, which is accorded high priority to serve as the engine of pro-poor economic growth. The interventions under SMESDP will be targeted at removing obstacles to SME growth and facilitating the flow of private investments into the SME sector and will complement existing government reform measures and other ADB and development agency assistance programs in private and financial sector development. Moreover, SMESDP is fully consistent with ADB's country strategy and is complementary to ADB's interventions in Bangladesh in rural and microfinance and in financial market development, which helps improve resource mobilization and access to credit by SMEs.

II. COST ESTIMATES AND FINANCING PLAN

A. Adjustment Costs

19. The total adjustment costs estimated at \$33.4 million equivalent comprise (i) the development of SME policy and development framework and institutional setup for policy implementation; (ii) loss of revenues from tax incentives to small enterprises; (iii) establishment and operation of SME support infrastructure including the integrated database, web portal, helpline outreach centers, and e-governance infrastructure; and (iv) rationalization and improvement of government assistance to SMEs including restructuring of SCITI, restructuring of BSCIC, and upgrading of facilities and capacity building of BSTI. Under restructuring of BSCIC or its replacement, the Program will provide budgetary support for financial restructuring costs to cover its accumulated operating losses, staff rationalization, voluntary retirement, termination of excess personnel (particularly those not authorized to be in the employee roster), and recruitment of qualified professionals for specific important positions. The breakdown of adjustment costs is in Table 1.

Table 1: Estimate of Adjustment Costs
(\$ million)

Item	FY2005	FY2006	FY2007	FY2008	Total
SME Policy Development and Implementation	0.6	0.4	0.8	0.5	2.3
Tax Incentives	0.4	0.8	1.2	1.8	4.2
SME Support Infrastructure and E-Governance	1.7	2.2	1.3	1.2	6.4
Restructuring of Concerned Agencies under MOI Involved in the SME Sector	15.1	3.9	0.8	0.7	20.5
Total	17.8	7.3	4.1	4.2	33.4

FY = fiscal year, MOI = Ministry of Industries, SME = small and medium enterprise.

Source: Asian Development Bank staff estimates.

B. Financing

20. The program loan of SDR9.954 million (\$15 million equivalent) will be from ADB's Special Funds resources, with an amortization period of 24 years, including a grace period of 8 years, and with an interest rate of 1.0% per annum during the grace period and 1.5% per annum thereafter. The loan closing date is expected to be 31 December 2007. Other terms and conditions are set out in the Program Loan Agreement.

III. IMPLEMENTATION ARRANGEMENTS

A. Executing Agency and Implementing Agencies

21. The executing agency (EA) for the program loan is the MOF, Finance Division (MOF-FD). The EA has constituted a central program coordination unit (CPCU) in charge of program monitoring and coordination. The CPCU is a committee headed by the Joint Secretary, MOF-FD with members from Economic Relations Division, MOF, Ministry of Industries, Bangladesh Bank and with representation from ADB. The implementing agency (IA) for the program loan is the MOI, except for the tax incentive measures, which MOF-FD will coordinate with the National Board of Revenue.

B. Project Management Organization

Table 2: Key Functions of the Executing Agency

Executing Agency	MOF-FD
Key Functions	<ul style="list-style-type: none"> • Organize the CPCU. • Ensure compliance with the tranche conditions of the program loan. • Submit to ADB withdrawal application from the loan account. • Open an account (the Deposit Account) at Bangladesh Bank into which all withdrawals from the loan account shall be deposited. • Submit trade statistics to assess the Borrower's compliance with the formula for determining eligible Imports. • To establish a program performance management system as agreed with ADB, within 6 months of the effective date of the SMESDP loans, and cause it to be operated throughout the program period. • Liaise with IA and ADB to address any implementation issues. • Ensure that all ADB-financed goods and services procured do not violate or infringe any industrial property or intellectual property right or claim of any third party. • Ensure that all ADB-financed contracts for the procurement of goods and services contain appropriate representations, warranties and indemnities from the contractor. • Organize audits of the project accounts by chartered accountants annually.
	CPCU
Key Functions	<ul style="list-style-type: none"> • Coordinate activities between the various entities involved in delivering outputs of the Program. • Oversee the implementation of policy actions including compliance with tranche release conditions and related project loan components. • Ensure effective management, close monitoring and timely reporting of the SMESDP. • Ensure timely submission of IA of reports for consolidation and submission to ADB.

Table 3: Key Functions of the Implementing Agency

Implementing Agency	MOI/SME Cell
	<ul style="list-style-type: none"> • Prepare SME Policy and Development Framework and SME Action Program. • Implement the SME Policy, Development Strategy and Action Program. • Undertake studies on rationalization of Government assistance to the SME sector funded by the TA Loan and implement recommendations from these studies, including submission of a timebound, monitorable plan, commencement of implementation of recommended actions,

possible overall restructuring of BSCIC and rationalization of credit programs directly provided by the Government.

- Complete human resource restructuring of the BSCIC head office and field offices.
- Recruit experienced professionals and academic faculty members for SCITI.
- Constitute a committee for implementation of E-governance.
- Operationalize the SME web-portal/virtual front office.
- Establish SME helpline centers.
- Undertake the policy actions specified in the policy matrix that are under the purview of MOI and provide the necessary support for ensuing compliance with the tranche conditions of the program loan.
- Prepare quarterly progress reports on the program loan and submit to MOF-FD for submission to ADB.

IV. IMPLEMENTATION SCHEDULE

22. SMESDP implementation is expected to last 3 years and is scheduled for completion in December 2008. The program implementation schedule is included in Appendix 2.

V. PROCUREMENT OF GOODS

23. The program loan will finance the full foreign exchange costs (excluding local duties and taxes) of imports procured in and from ADB's member countries, other than those specified in the list of ineligible items (Appendix 3) and those items financed by other multilateral and bilateral official sources.

VI. DISBURSEMENT PROCEDURES

24. **Disbursement procedures** - Disbursements under the program loan will be made in line with ADB's simplified disbursement procedures and audit requirements. The Borrower should submit a withdrawal application (Appendix 4). Prior to submitting the first application to ADB for withdrawal from the loan account (i.e. the first tranche release), the People's Republic of Bangladesh (Borrower) shall open an account at Bangladesh Bank into which withdrawals for the tranche releases shall be deposited.

25. For withdrawal of the loan proceeds, the Government as the Borrower will certify that the value of eligible imports exceeds the amount of ADB's projected disbursements under the program loan in a given period. ADB will have the right to audit the use of loan proceeds and to verify the accuracy of the Borrower's certification.

26. **Tranching.** The loan proceeds will be available for withdrawal upon satisfactory compliance with the agreed tranche conditions (Appendix 5). The first tranche of \$5 million equivalent will be released upon effectiveness of the loan and fulfilment of the first tranche release conditions. The second tranche of \$10 million equivalent is expected to be released by end-June 2007, upon fulfilment of the second tranche release conditions.

VII. PROGRAM MONITORING AND EVALUATION

27. The Borrower shall implement a performance monitoring system for monitoring and evaluation of the Program during and after implementation in accordance with a schedule to be agreed upon with ADB. MOF-FD will monitor implementation of SMESDP.

VIII. AUDITING REQUIREMENTS

28. The financial reporting and auditing requirements are also spelled out in the attached draft (sample) audit letter (Appendix 6), which will be issued to the borrower and copied to the EAs and their appointed auditor.

IX. MAJOR LOAN COVENANTS

29.. In addition to the standard conditions and the tranche release conditions, the following major covenants are included in the Loan Agreement. These covenants are directly related to the Program and are considered essential to ensure its successful implementation.

Use of Counterpart Funds

30. The Borrower shall ensure that the Counterpart Funds shall be used to finance the Program expenditures and associated costs of reform.

Implementation of the Policy Letter and Policy Matrix

31. The Government will maintain the policies adopted and actions taken prior to the date of the Program Loan Agreement and promptly adopt the other policies and take the other actions included in the SMESDP, in each case as described in the development policy letter and the policy matrix, and ensure that such policies and actions continue in effect for the duration of SMESDP and subsequently. The Government will consult with ADB in preparing and finalizing the SME policy and development framework, including the inclusion as appropriate of internationally accepted market-based principles regarding SME development.

32. The Government will ensure, through an active consultation process, the participation of various stakeholders including the private sector, financial institutions, development partners, nongovernment organizations, and research and academic institutions in the finalization and implementation of the SME policy and development framework and the components under such policy, as detailed in the policy matrix.

Gender-related Issues

33. The Borrower shall ensure that (i) women entrepreneurs are represented in the preparation of the SME Policy and Development Framework, and (ii) women entrepreneurs are represented on the National Council for Industrial Development through the president of a national women entrepreneurs association. The Borrower shall also ensure that the SME database has gender-disaggregated data on matters including the number of women entrepreneurs and women employees, as well as their position in the organization structure (operational or management level).

SME Credit Facilities

34. The Borrower shall ensure that the performance of credit facilities currently administered directly by various Government agencies and public sector financial institutions are reviewed and measures are taken to improve the targeting and efficiency of utilization of such facilities. The Borrower shall also ensure that, in a phased manner, management of the SME credit facilities currently directly administered by the Bangladesh Bank for the Government shall be transferred to the SME Foundation to be established under the Program.

Program Coordination and Management

35. MOF-FD has organized the CPCU which will coordinate activities between the various entities involved in delivering outputs of the Program.

36. The Borrower shall establish a program performance management system as agreed with ADB, within six (6) months of the Effective Date, and cause it to be operated throughout the Program period. Under the Program performance management system, the Borrower shall also undertake periodic review of the Program to assess and evaluate the scope, implementation arrangements, monitoring, progress and achievement of the Program.

X. ANTICORRUPTION

37. The Project is subject to ADB's Anticorruption Policy. Anyone coming across evidence of corruption associated with the project is required to contact ADB's Office of the General Auditor, which will investigate allegations. Further information on ADB's anticorruption policy is available through ADB's website: <http://www.adb.org> (and selecting 'anticorruption' as topic), or directly through: <http://www.adb.org/Documents/Policies/Anticorruption/default.asp>.

XI. KEY PERSONS INVOLVED IN THE PROGRAM

38. All official communication related to the Program should be addressed to the following key personnel:

Names	Company	Position	Address	Telephone / Fax No./ Email address
TBD	ADB	Director	No. 6 ADB Ave., Mandaluyong, Phil.	T-632-6325369 F-632-6362337 Email:
V.T.Velasco	ADB	Sr. Financial Economist	No. 6 ADB Ave., Mandaluyong, Phil.	T-632-6325369 F-632-6362337 Email: vtvelasco@adb.org
R. M. Limjoco	ADB	Lead Financial Sector Specialist	No. 6 ADB Ave., Mandaluyong, Phil.	T-632-6324444 F-632-6362337 Email: rlimjoco@adb.org
Mr. Quddus Khan	MOF-FD	Joint Secretary, (Banking Policy)	Bangladesh Secretariat, Dhaka	T-7165526 F-8615581

POLICY MATRIX

COMPONENT	ACTIONS TAKEN PRIOR TO BOARD CONSIDERATION	FIRST TRANCHE	SECOND TRANCHE
Policy Outcome 1: Establish Small and Medium Enterprise (SME) Policy and Development Framework			
1.1 Declare SMEs as a priority sector under Government Policy		Government to state the development of SMEs as a priority under the Industrial Policy and the Poverty Reduction Strategy Paper. ^a	
1.2 Formulate an SME Policy and development framework	<p>Government to establish a Task Force for SME Policy Development.</p> <p>Government to hold a national workshop with the participation of various stakeholders, including the Government, private sector, financial institutions, donors, nongovernment organizations, and research and academic institutions, in order to identify problems, constraints, opportunities and issues regarding the development of SMEs in the country.</p> <p>Government Task Force to prepare and submit its recommendations for SME development, based on the results of the national workshop, to the Prime Minister.</p>	<p>Government to adopt a single, uniform definition of SMEs and incorporate such definition under the Industrial Policy.^a</p> <p>National Task Force on Development of SMEs to finalize and submit the Report on Development of SMEs to the Government for the formulation of the SME Policy.^a</p>	Government to approve the SME Policy and disseminate the summary SME Policy to the public in the Bangla and English languages in at least three newspapers of nationwide circulation. ^a
Policy Outcome 2: Establish Institutional Framework and Mechanisms to Support SME Development			
2.1 Set up an structure and mechanism to implement the SME Policy and development framework		<p>National Council for Industrial Development (NCID) to be responsible for the promotion, growth, and development of SMEs, in addition to its other responsibilities under the Industrial Policy.^a</p> <p>Ministry of Industries (MOI) designated to implement SME Policy.^a</p> <p>SME Cell organized within the MOI to implement the SME development action program.^a</p>	<p>SME Advisory Panel to be constituted and mandated to develop an action program to implement the SME Policy. The Panel will consist of representatives from the MOI and other concerned ministries, industry associations, and representatives from the private sector and academia, and report to the Guidance Committee set up under the Industrial Policy.^a</p> <p>Government to approve Memorandum and Articles of Association for setting up SME Foundation, with at least 50% private sector representation on the Board and a Chief</p>

Continued on next page

COMPONENT	ACTIONS TAKEN PRIOR TO BOARD CONSIDERATION	FIRST TRANCHE	SECOND TRANCHE
			Executive Officer recruited from the private sector, to be set up to assume the responsibilities of implementing the SME Policy from the SME Cell and to take over, in a phased manner, management of SME credit facilities currently directly administered by the Government. ^a
Policy Outcome 3: Define Government Support to SMEs, and Improve SME Access to Various Services			
3.1 Rationalize Government assistance to the SME sector including the restructuring of Bangladesh Small and Cottage Industries Corporation (BSCIC) and other concerned agencies under MOI involved in the sector and rationalization of direct credit assistance currently provided	Government to take policy decision regarding human resource restructuring of BSCIC field offices.	<p>MOI to commission a study to be financed by the Technical Assistance (TA) loan to determine effective approaches for delivering assistance to SMEs, including possible restructuring options for BSCIC.</p> <p>Government to take policy decision regarding human resource restructuring of BSCIC head office.</p> <p>MOI to commence review of individual cases under restructuring plan for BSCIC field offices.</p>	<p>MOI to implement recommendations from the study funded by the TA Loan, including the submission of a time-bound monitorable plan, commencement of implementation of recommended actions, and possible overall restructuring of BSCIC.^a</p> <p>MOI to complete human resource restructuring of BSCIC field offices and head office.^a</p>
3.2 Rationalize incentive and tax structure for SMEs		As part of the recommendations of the National Task Force on Development of SMEs, Government to review the current fiscal incentives being provided to SMEs with the end in view of enhancing fiscal support to SMEs.	Government to provide tax incentives to SMEs to take effect from assessment year FY2005/6; by then, for SMEs with fixed investment (excluding land and buildings) less than Tk3 million, provide, as a minimum, (i) a 75% income tax rebate, and (ii) accelerated depreciation rates for, inter alia, plant and machinery. Such tax incentives to apply for a minimum period of 5 years for SMEs located in Dhaka, Chittagong, and other major cities, and for a longer period to SMEs located in underdeveloped and undeveloped areas. Such tax incentives will not apply to SMEs availing of tax incentives under existing export incentive schemes. ^a

COMPONENT	ACTIONS TAKEN PRIOR TO BOARD CONSIDERATION	FIRST TRANCHE	SECOND TRANCHE
3.3 Enhance SME access to market and Government services		MOI to constitute committee for implementation of e-governance that will include (i) the development of an SME web portal/virtual front office, and (ii) the establishment of SME helpline outreach centers to provide coordination and assistance for facilitating access to Government services by SMEs. ^a	MOI to operationalize the SME web portal/virtual front office to provide information on market opportunities regarding SMEs and to facilitate access to Government services by SMEs, including start-up assistance. ^a MOI/BSCIC, in partnership with the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), and district chambers and line associations of FBCCI, to establish SME helpline outreach centers at the district offices of BSCIC to assist SMEs in their organizational and expansion activities. ^a
3.4 Enhance SME access to capacity building	Government to upgrade Small and Cottage Industries Training Institute (SCITI) from a development project to a regular revenue budget agency of BSCIC.	MOI to recruit experienced professionals and faculty members for SCITI. ^a SCITI in collaboration with FBCCI, district chambers and line associations of FBCCI, accredited women entrepreneurs' associations, and National Association of Small and Cottage Industries of Bangladesh (NASCIB) to commence a training needs assessment for SMEs, for the development of suitable and affordable training programs to reach out to SMEs, particularly those located in rural areas, participating financial institutions under the Small Enterprise Fund (SEF), women entrepreneurs, and displaced workers in the readymade garment industry. ^a	SCITI in collaboration with FBCCI, district chambers and line associations of FBCCI, accredited women entrepreneurs' associations, and NASCIB to offer training programs in accordance with the results of the training needs assessment. ^a

COMPONENT	ACTIONS TAKEN PRIOR TO BOARD CONSIDERATION	FIRST TRANCHE	SECOND TRANCHE
3.5 Enhance SME access to product certification and upgrade product certification system to international standard	MOI to draft Accreditation Law.	Bangladesh Standards and Testing Institution to set up a special window for certifying SME products. ^a Cabinet to approve draft Accreditation Law.	Government to introduce Accreditation Bill before Parliament. ^a Government to set up an autonomous Accreditation Board. ^a Accreditation Board to apply for membership in International Accreditation Forum. ^a
3.6 Develop an integrated SME database		Bangladesh Bureau of Statistics (BBS) to publish report on the Census of Non-Farm Economic Activities (urban and non-urban, 2001–2003).	MOI and BBS to prepare a registry of enterprises (nonagricultural) and conduct a nationwide survey of SMEs for establishment of an integrated SME database that will serve as the basis for monitoring SME performance and development and for targeting assistance. ^a

^a Tranche release condition

PROGRAM IMPLEMENTATION SCHEDULE

Item	2005	2006	2007	2008	2009	2010
A. Loan Effectiveness	■					
B. Tranche Release		■				
C. Program Loan						
1. Establish SME Policy and Development Framework						
1.1 Declare SMEs as a Priority Sector under Government Policy		■				
1.2 Formulate SME Policy and Development Strategy		■				
2. Establish Institutional Structure and Mechanisms to Support SME						
2.1 Set Up an Institutional Structure and Mechanisms to Implement the SME Policy and Development Framework			■			
2.2 Prepare an Action Program to Support the SME Development Strategy		■				
3. Define Government Support to SMEs and Improve SME Access to Various Services						
3.1 Rationalize Government Assistance to the SME Sector including the Restructuring of BSCIC and Other Concerned Agencies under MOI, and Rationalization of Government Direct Credit Assistance Currently Provided			■			
3.2 Rationalize incentive and Tax Structure for SMEs			■			
3.3 Enhance SME Access to Market and Government Services			■			
3.4 Enhance SME Access to Capacity Building			■			
3.5 Enhance SME Access to Product Certification and Upgrade Product Certification System to International Standard			■			
3.6 Develop an Integrated SME database			■			
D. Project Loan						
1. SEF Disbursement		■	■	■	■	■
2. Fund Utilization Monitoring and Reporting System		■	■	■	■	■
3. Semiannual Review		■	■	■	■	■
4. Benefit Monitoring		■	■	■	■	■
E. TA Loan						
1. Rationalization of Government Assistance to SMEs				■		
2. SME Web Portal/Virtual Front Office Development			■			
3. Establishment and Operation of SME Helpline Outreach Centers				■		
4. Targeted SME Capacity Building						
4.1 Rural-Based Enterprise Training			■			
4.2 Women Entrepreneurs Training		■				
4.3 Skills Retraining Displaced RMG Workers				■		
4.4 Development of SME Lending Capability of PFIs				■		
5. Upgrading of Product Certification System		■	■	■		
6. Integrated SME Database Development		■	■	■		
7. Environmental Assessment and Monitoring			■	■		
F. Monitoring and Review				■	■	■
G. Procurement and Consulting Services				■	■	■
H. TA Grant Implementation				■		

LIST OF INELIGIBLE ITEMS

1. The proceeds of the loan will be utilized to finance the foreign exchange expenditures for the reasonable cost of imported goods (excluding any dues or taxes) required during the execution of the Small and Medium Enterprise Sector Development Program. All imported goods financed from the proposed loan must be produced in, and procured from, Asian Development Bank member countries.

2. Notwithstanding the provisions of para.1, no withdrawals will be made from the loan account in respect of the following:

- (i) expenditures for goods included in the following Customs Coordination Council Nomenclature chapters of headings:

<u>Chapter</u>	<u>Heading</u>	<u>Description of Items</u>
22	22.03–22.10	Alcoholic Beverage
24	24.01	Tobacco, unmanufactured tobacco refuse
24	24.02	Tobacco, manufactured (whether or not containing tobacco substitutes)
28	28.50–28.52	Radioactive and associated materials
71	71.01–71.04	Pearls, precious and semi-precious stones, unworked or worked
71	71.05–71.06	Jewelry of gold, silver, or platinum group metals (except watches and watch cases) and goldsmiths or silversmiths wares (including set gems)
71	71.07–71.08	Gold, non-monetary (excluding gold ores and concentrates)
84	84.59	Nuclear reactors and parts thereof, fuel elements (cartridges), non-irradiated for nuclear reactors

- (ii) expenditures for goods intended for a military or paramilitary purpose or for luxury consumption; or
- (iii) expenditures for pesticides categorized as extremely hazardous or highly hazardous in Class 1a and 1b of the World Health Organization's Classification of Pesticide by Hazard and Guidelines to Classification.

**Conditions for Release of the First Tranche (Ref. Program Loan Agreement , Attachment 2 to Schedule 3).
Compliance Deadline: Upon effectiveness of the loan and fulfillment of the first tranche release conditions.**

1. Borrower shall have declared the development of SMEs as a priority under its Industrial Policy and the Poverty Reduction Strategy Paper.
2. Borrower shall have adopted a single, uniform definition of SMEs and incorporated such definition under the Industrial Policy.
3. National Task Force on Development of SMEs of the Borrower shall have finalized and submitted the Report on Development of SMEs to the Government for the formulation of the SME Policy.
4. Borrower shall have assigned responsibility for the promotion, growth, and development of SMEs to the National Council for Industrial Development (NCID), in addition to NCID's other responsibilities under the Industrial Policy.
5. Borrower shall have designated MOI as the responsible agency of the Borrower to implement the SME Policy.
6. Borrower shall have assigned responsibility for implementing the SME development action program to the SME Cell organized within the MOI.
7. MOI shall have constituted a committee for implementation of E-governance that will include (i) the development of an SME web-portal/virtual front office, and (ii) the establishment of SME helpline outreach centers to provide coordination and assistance for facilitating access to Government services by SMEs.
8. MOI shall have recruited experienced professionals and academic faculty members for SCITI.
9. SCITI, in collaboration with the Federation of Bangladesh Chambers of Commerce and Industry, district chambers and line associations of such Federation, accredited women entrepreneurs' associations and the National Association of Small and Cottage Industries of Bangladesh (NASCIB), shall have commenced a training needs assessment for SMEs, for the development of suitable and affordable training programs to reach out to SMEs, particularly those located in rural areas, participating financial institutions (PFIs) under the SEF, women entrepreneurs, and displaced workers in the readymade garment industry.
10. Bangladesh Standards and Testing Institution shall have established a special window for certifying SME products.

Conditions for Release of the Second Tranche, Reference Program Loan Agreement Attachment 3 to Schedule 3. Compliance Deadline: by end June 2007.

1. Borrower shall have approved the SME Policy and disseminated a summary of the SME Policy to the public in the Bangla and English languages in at least three newspapers of nationwide circulation.
2. Borrower shall have constituted the SME Advisory Panel and mandated it to develop an action program to implement the SME Policy. The SME Advisory Panel shall be comprised of representatives from MOI and other concerned ministries, industry associations, and representatives from the private sector and academia, and report to the Guidance Committee set up under the Industrial Policy.
3. Government shall have approved the Memorandum and Articles of Association for establishing the SME Foundation, with at least 50% private sector representation on the Board and a Chief Executive Officer recruited from the private sector, to be set up to assume the responsibilities of implementing the SME Policy from the SME Cell and to take over, in a phased manner, management of SME credit facilities currently directly administered by the Government.
4. MOI shall have commenced implementation of recommendations from the study funded by the TA Loan, including the submission of a timebound, monitorable plan, commencement of implementation of recommended actions, and possible overall restructuring of BSCIC.
5. MOI to have completed human resource restructuring of the BSCIC head office and field offices.

6. Borrower shall have provided the following tax incentives to SMEs to take effect from assessment year FY2005/6: for SMEs with fixed investment (excluding land and buildings) less than Taka 3 million, as a minimum, (i) a 75% income tax rebate, and (ii) accelerated depreciation rates for, inter alia, plant and machinery. Such tax incentives shall apply for a minimum period of five years for SMEs located in Dhaka, Chittagong, and other major cities, and for a longer period to SMEs located in underdeveloped and undeveloped areas. Such tax incentives shall not apply to SMEs availing of tax incentives under existing export incentive schemes.
7. MOI and the Bangladesh Bureau of Statistics shall have prepared a registry of enterprises (non-agricultural) and conducted a nationwide survey of SMEs for establishment of an integrated SME database which will serve as the basis for monitoring SME performance and development and for targeting assistance.
8. MOI shall have operationalized the SME web-portal/ virtual front office to provide information on market opportunities regarding SMEs and to facilitate access to Government services by SMEs, including start-up assistance.