

## A Study on Financing of SME's in Bangladesh

Md. Taslim Uddin

Lecturer, Department of Business Administration, Southern University Bangladesh  
Academic Building-2, 739/A Mehedibag Road, Chittagong, Bangladesh  
Email: [taslimcu@gmail.com](mailto:taslimcu@gmail.com)

### Abstract:

Bangladesh is now dreaming to become the middle income country within 7 to 8 years. The governor of Bangladesh bank advocated that every year 2% poverty reduced in Bangladesh consequently at present the people who lived in under the poverty line is 27%. The contribution of SME sector in this regard was incredible. Diverse hurdle likes limited financing, high interest rate; poor infrastructure, credit information gap etc make the performance of SMEs below the global standard. This study is an academic analysis to identify some of the constraints related with SMEs financing and some policy implications for the future.

**Keyword:** SME financing, GDP contribution, poverty alleviation.

### 1. Prelude:

Small and medium enterprises (SMEs) are acknowledged worldwide as lifeblood of local trade, commerce and industry. With lower energy supply, lesser infrastructure facilities and minor environmental risk SMEs contributes notably to alleviation of poverty, create employment opportunities, women empowerment and equitable distribution of income as well as diversification of industrial sector in Bangladesh. SMEs account for about 45% of manufacturing value addition. They account for about 80% of industrial employment, about 90% of total industrial units and about 25% of total labor force. Their total contribution to export earnings varies from 75- 80%. The total number of SMEs is estimated at 79754 establishments, of which 93.6% are small and 6.4% are medium which contributed around 20-25% of GDP.(source: Agricultural credit and special programs department, Bangladesh Bank)

Commercial banks are the key sources of SME financing. But only a few years ago many major regional banks chose to ignore the needs of small and medium sized business. Continuous monitoring, facing problem of to recover the loan amount distributed to the SME sectors and high risk with low return rather than industrial loans makes consider as SME financing as less attractive to the commercial banks. So in this situation, Bangladesh bank performs a crucial responsibility to the SME financing for the advancement of Bangladesh's economy. From year 2010, Bangladesh Bank sets target of SME loan for government and private banks operating in Bangladesh. In year 2011. Most of the banks was fail to achieve their target but janata Bank( target amount 2000 crore tk, provided 2011 crore tk, 101.59% of their target amount) and Jamuna Bank (target amount 472.50 crore tk, provided 704.72 crore tk, 149.08% of their target amount ). Still the involvement of commercial banks in this sector relatively insignificant.

### 2. Literature review:

Chowdhury et. al (2013) have made a study on "Problems and Prospects of SME Financing in Bangladesh". The study found that SMEs contributes significantly in poverty reduction programs and potential contribution to the overall industrial and economic growth and suggested Venture Capital, Bank Syndication Scheme, HRD in Financial institutions and in Government offices, Training and Development etc as potential tools of eliminating the constrains of SMEs financing.

Akterrujjaman (2010) conducted a study "problems and prospects of SMEs loan management: A study on Mercantile Bank Limited, Khulna Branch" where major findings are related to the high interest and loan duration rates, reasons for SMEs relatively informal way of doing business in contrast to bank's formal procedures and prerequisites, bank's relative inexperience in this field.

Electrin et. al (2013) in his article "An Evaluation of Microfinance Services on Poverty Alleviation in Kisii County, Kenya" examine the effect of micro finance services on poverty reduction. The study suggested that the MFIs operating in the County be empowered through provision of finances which can be advanced to the locals as credit to facilitate rapid economic growth.

Aboagye and Acheampong (2013) conducted a study on "Wealth Creation through Micro Financing: Evidence from Small Scale Enterprises in Ghana". They found that personal sources were the main sources of funding for Small Scale Enterprises (SSEs) start-up and expansion. They concluded that MFIs should ensure that they understand the business of their clients to be able to design products and services that fit their needs.

Shamsuddoha and Nasir (2011) have made a study on "Micro Credit Program of Selected NGOs: An Empirical Study on Rural Poor Women " and evaluated the entrepreneurial program of reputed Non-government organization (NGO) and identifies Difficulty in getting loans, Inadequate and unintegrated supply of fund,

Higher rate of Interest, Premature recovery loan are the major problems facing the selected women entrepreneurs. Alam and Ullah (2006) in their study “SMEs in Bangladesh and Their Financing : An Analysis and Some Recommendations” found that lack of medium to long-term credit, limited access to market opportunities, technology, and expertise and business information. Lack of suitable incentives, inefficient and limited services from relevant government agencies as well as poor capacity of entrepreneurs are other reasons for the slow growth of SMEs. Study recommend that flourish, SMEs will create new entrepreneurs, generate more jobs and contribute to a great extent to the national economy.

Zaman and Islam(2011) in their article “Small and Medium Enterprises Development in Bangladesh: Problems and Prospects” considered smooth and sustainable development of SMEs all over the country will be one of the vehicles for poverty alleviation, and generation of more employment. They found Lack of Investment Finance and Working Capital Finance, Inability to Market SME Product, Lack of Skilled Technicians and Workers, Non-Tariff Barriers (NTB) and Changes in World Trade Regimes are the major financing constraints faced by SMEs in Bangladesh. And suggested Enhancing Access to SME Finance, Development of SME Infrastructure, Quality of SME Products, and Training Facilities for SME workers and Entrepreneurship etc are as some policy measures to overcome those constraints.

Chowdhury and Ahmed (2011) have made a working paper on “An Appraisal of the Problems and Prospects of Small and Medium Enterprises (SMEs) Financing in Bangladesh: A Study on Selected Districts”. They observed that non availability of adequate credit, complex loan granting procedure, inadequate infrastructure facilities, problems of collateral requirements, paucity of working capital, non availability of skilled work force; poor salary structure, lack of coordination among SME related organizations, lack of appropriate marketing strategies etc. are the major hindrances to the development of the SMEs in Bangladesh. They recommended easy loan application and disbursement procedure, fix the minimum salary, adequate finance for modernization, expansion and technological advancement of SMEs etc for the development of SMEs.

### **3. Objective of the study:**

The prime objectives of the current study are:

1. To highlight the SME financing policies in Bangladesh.
2. To identify the present situation of SME's in Bangladesh.
3. To expose the problems in SME financing and provide policy implication for superior SME performance.

### **4. Methodology of the study:**

The present study is based on secondary data. Thus the secondary date that used in this study was taken from diverse publications of Ministry of Industries, Bangladesh Bank, SME foundation, Bangladesh Bureau of Statistics, MIDAS, Financial Institutions, different journals regarding strategic issues are used to support the findings .And at the same time newspapers are also used for various information.

### **5. What is SME financing?**

SME can be defined by a simple sentence “Small Business with Big Opportunity”

Small Enterprise refers to those enterprises where goods are produced, recycled, repaired or traded in traditional way; where bank investments total is limited to Tk.250, 000; where 10 or fewer workers are engaged on wages or commission basis.

Medium Enterprise refers to those enterprises where goods are produced, recycled, repaired or traded applying some capital machinery; Where 20 or less people are engaged on wages or commission basis; where total bank investments does not exceed Tk.75, 00,000.

The definition published by Ministry of Industries and endorsed by Bangladesh Bank of SME is as follows:  
 Medium Industry/Enterprise

Nature of Enterprise	Total Fixed Assets (Excluding Land and factory building)	Total number of employees
Service Concern	Not exceeding to TK.15 Crore	Up to 100 person
Trading Concern	Not Exceeding to TK.15 Crore	Up to 100 person
Manufacturing Concern	Not Exceeding to TK.30 Crore	Up to 250 person

Small Industry/Enterprise

Nature of Enterprise	Total Fixed Assets (Excluding land & factory building)	Total no. of Employees
Service Concern	Not exceeding to TK.1.00 crore	Upto 25 persons
Trading Concern	Not exceeding to TK.1.00 crore	Upto 25 persons
Manufacturing concern	Not exceeding to TK.10.00 crore	Upto 99 persons

The European Union (EU) defines SMEs as independent enterprises, not owned, up to 25% or more of the capital or voting rights by one or jointly by several enterprises. SME employs fewer than 250 employees with an annual turnover not exceeding 40 million Euros or the annual balance sheet total does not exceed 27 million Euros.

## 6. Why SME:

The SME plays a vital role in our developing economy. Some charismatic advantages stimulate the entrepreneurs to set up small and medium enterprises. These are as follows:

### 1. Low investment:

To start a small enterprise one need not large investment, by using SME loan one can start a business.

### 2. Favorable Government policy:

Our government policy is always favorable to small medium enterprises. Various facilities and incentives are provided by government to SME sector.

### 3. Cheap labor:

Labor is cheap and available in our country. We can use this labor force in lower cost, which is favorable for SME sector.

### 4. Self employment:

Bangladesh is facing severe unemployment problem. A large portion of our educated people is searching for job. Provided with proper training and capital assistance they can engaged in small scale businesses.

### 5. Raw material:

There is abundance of some raw material such as bamboo, jute, wood, etc. So basing on these raw materials small and medium enterprises can set up in our country.

### 6. Employment Generation:

Bangladesh is a densely populated country. Job opportunity here is very scanty; Unemployment rate is approximately 40%. Therefore, it is the prime concern for the nation to generate income through creation of job opportunity & employment. Creation of job opportunity at large scale by us is not possible. What can be done better is to help self-employment through SME financial support.

### 7. Economic Growth:

Small and Medium Enterprises (SMEs) play a vital role in the economic growth and development of the country, especially in one like ours. Bangladesh has approximately six (6) million micro, small, and medium enterprises with less than 100 workers, out of which around 27,000 are SMEs. Micro, small, and medium enterprises provide more than 75% of the income of the households in Bangladesh. The sector contributes nearly 25% of the GDP, 40% of gross manufacturing output, 80-85% of industrial jobs and constitutes around 25% of the total labor force making this sector an attractive one for lending by financial institutions.

### 8. Industrial development:

In Bangladesh, Small and Medium Enterprises (SMEs) are significant contributors to manufacturing growth and employment creation, which facilitate industrial development. The share of SMEs in the manufacturing sector in terms of fixed capital, gross investment and sales is 48 percent, 33 percent and 40 percent respectively.

## 7. Policies of procedure of SME financing:

Since most of the Bangladeshi firms fall under SME, Government has to provide proper rules and regulations and suggest some standard policies to accelerate the economic growth of Bangladesh.

In the year 2009 Bangladesh Bank established SME department. Since 2010 to March, 2013 more than

tk.1963.69 billion SME loan has been distributed among 13,09,277 entrepreneurs. Where 32% in production sector, 62% in commercial sector and 6% in service sector.

Bangladesh Bank has recently established “SME and Special Programmers Department” for policy formulation, facilitating fund, monitoring and development of entrepreneurship in the SME sector.

The policy and guideline formulated by this department are demonstrated below:

1. Fix up an indicative target for SME loan disbursement for all the banks and financial institutions operating in Bangladesh. banks/financial institutions will follow the 'Area Approach Method' to attain their targets separately by dividing it as branch wise, region wise & sector wise.
2. A separate business strategy for SME financing with least documentation and speedy loan sanction.
3. For small entrepreneurs credit limit will be ranged from Tk. 50,000 (Fifty thousand) to Tk.50, 00,000 (Fifty lac).
4. Women Entrepreneurs will be given priority in the SME sector. Establishing “Women Entrepreneurs Dedicated Desk” is essential for all banks and other financial institutions. At least 15% of total sanction will be held in reserve in favour of the women entrepreneurs and the interest rate will be 10% only. Institutions may sanction up to Tk. 25,00,000 to women entrepreneurs against personal guarantee. In that case, group security/social security may be considered.
5. Arranged training facilities for the entrepreneurs.

### 8. Present scenario of SMEs in Bangladesh:

According to ADB( Asian development bank), about 6 million SMEs and micro enterprise firms of less than 100 employees contribute significantly in economic development and create job opportunities in Bangladesh specially when the unemployment rate is approximately 40% and 36% people still live under the poverty line. SMEs also contribute enormously to the GDP of Bangladesh.

**Table 1:** Contribution of SMEs in the GDP on Bangladesh

Numbers of workers	Total Contribution to GDP (Taka)	Percentage of Total contribution
0-1	193 996 555 714	26
2-5	379 663 897 358	51
6-10	73 120 983 681	10
11-20	45 183 240 157	6
21-50	33 960 498 076	5
51-100	15 138 922 373	2
Total	741 064 097 360	100

Source: ICG/MIDAS Survey, 2007

Note: US \$ 1 = BDT 69.00

Table-1 depicts the contribution of SMEs in GDP of Bangladesh. it is reflected that micro enterprises operate by the 2-5 workers has the highest contribution(51%) in the total contribution of SMEs in the GDP. More concisely, 86% of the contributions come from the SMEs where the numbers of workers are up to 10 and the enterprises run by more than 21 workers contribute only 7% of the total contribution from SMEs to GDP in Bangladesh.

**Table 2:** Sector wise contribution of SME in GDP of Bangladesh (Taka)

Sector	Total Contribution to GDP (Taka)	Percentage of Total Contribution
Agriculture	177 729 637637	24
Fishing	32 872 674 464	4
Construction	7 196 460 200	1
Manufacturing	282 344 700 575	38
Wholesale and Retail trade and Repairs	171 335 861 390	23
Hotels and Restaurants	28 599 263 975	3
Transport, Storage and Communication	8 950 171 356	1
Real state, Renting and Business activities	13 771 436 794	2
Education	151 808 506	1
Health and Social Work	2 743 049 893	1
Other Service activities	15 632 094 785	2
Total	741 327 159 609	100

Source: ICG/MIDAS Survey, 2007

Note: US \$ 1 = BDT 69.

It is observed from the table 2, manufacturing sector contributes 38% that is the peak contribution in GDP. 47% of the contribution in GDP comes from jointly agriculture and whole sale and retail sector.

In spite of having extensive contribution the poverty alleviation, economic growth and social advancement, SMEs are still disregarded by the formal financial institutions. Due to High administrative costs, low capitalization, insufficient assets, fail to meet collateral requirement etc. banks and other formal financial institutions are unenthusiastic to expand their credit portfolios.

The following table shows the total amount of financing and the total amount of SME financing based on the nature of the banks.

**Table3:** the total amount of financing and the total amount of SME financing based on the nature of the banks. ( In Crore)

SL	Bank	Position as on 30.06.2013		Percentage
		Total Financing	SME Financing	
1	State owned banks	90224	13350	14.80%
2	Specialized banks	29612	7950	26.85%
3	Private Commercial Banks	295835	73788	24.94%
4	Foreign Commercial banks	23346	2403	10.20%
Total		439020	9743	22.22%

Sources: Bangladesh bank, 2013

The following table shows amount of SME financing based on service, trading and manufacturing sector

**Table4:** amount of SME financing in different sector ( In Crore)

Sector	SME Amount		Growth
	30.06.12	30.06.13	
Service	1638	2209	34.85%
Trading	2053	27769	37.7%
Manufacturing	10463	11869	13.44%

Sources: Bangladesh bank, 2013

But the matter of hope is that Bangladesh bank is trying to make SMEs attractive to the formal financial sector. Bangladesh bank provides relatively cheaper funds to the banks and charges only 5% interest rate on these funds while lending institutions make decision on the lending rate of interest. Besides this, International Development Agency (IDA) has supplied us \$10 million to enterprise growth and bank modernization project. Moreover, ADB also agreed to provide \$30 million in this sector. (Jesmin, Rubayat, 2009)

### 9. Constraints of SME financing in Bangladesh

At present SME sector is facing a lot of barrier in Bangladesh. The major constraints are:

1. Inadequate fund:

Banks and other financial institutions set a specified limit for SME financing. If big amount financing require for the expansion of existing business or pursuing new venture then it is difficult to collect require fund from the bank.

2. Project Preparation and Evaluation:

Regardless of Bangladesh bank instruction, Loan application process for SMEs financing is still lengthy. On the other hand, it is quiet difficult to the entrepreneur to prepare a formal project proposal. Even when he prepares the proposal drawing on outside expert services, there is no guarantee that the proposal will be evaluated properly

3. High cost of financing:

Although financial institutions obtain cheap cost funds from Bangladesh bank and other donor agencies, still they charge high interest rate on SME financing. The rate is almost 13-17% and this high rate is on the prime hitch of the growth of small and medium enterprises.

4. Limited sources of financing:

Banks are the major sources of SMEs external financing but the limited network of banks restricts borrowers' access to credit. So most of the cases they needed to depend on retained earnings and informal sources of credit where the costs are extremely high.

5. Collateral requirement:

Banks demand good collateral as a safeguard and reduce risk exposure from the small and medium enterprises. But most of the SMEs fail to comply with this requirement of the banks and deprived of SME loan facility.

6. Technology:

Due to adequate capital and lack of skill workers, SMEs are needed to depend on simple technology base and highly labor intensive business.

7. Infrastructure:

SMEs in Bangladesh are facing difficulties by the poor infrastructure like electricity, water, roads and highway.



#### 8. Information:

Most of the SMEs have very limited technology. Accounting package is used by 1-2% of the SMEs and the rate is 15% who used computer. Only 8-10% SMEs use internet for their business purpose.

#### 9. Lack of education among the entrepreneur:

Most of the entrepreneurs are not well educated so they face trouble to make a business through micro enterprise and selecting the appropriate sources of their necessary fund.

#### 10. Other constraints:

At present china, Taiwan, Korea, India and Taiwan supply different product at a very cheap rate. Sometimes their product price is less than the production costs of our local SMEs products.

### **Recommendations:**

In order to improve the performance of the SME and targeting group for the SME, the following measures have been suggested

1. Banks and other formal financial institutions need to be increased the limit of SME financing and they also need to change their view towards it.
2. Government as well as Bangladesh bank need to be established a standard format and policy for SME loan proposal and project evaluation. Beside this, close monitoring of the banks activities regarding SME loan evaluation is crucial.
3. The interest rate should be lowered. It is must to make easy entrance to SME financing.
4. For the development of SMEs, only banks and donor funds are not sufficient. Government and other related forces need to create more diverse sources of SME financing.
5. To overcome the constraint of collateral, the banks are required to relax their collateral requirement of the banks.
6. Government and financial institutions may provide sufficient fund for advance technology.
7. To overcome the obstacle of infrastructure the government of Bangladesh needs to take appropriate measure to improve infrastructure of Bangladesh for the optimum growth of SMEs.
8. Government of Bangladesh should take measures like publicity in media, separate web page design, information office etc for proving all necessary information regarding SME financing.
9. Different training programs, work shop and formal educational curriculum should be included in for increasing entrepreneurial skill.
10. Government can be imposed different restriction on imported SMEs' product to protect our local company.

### **Conclusion:**

Small and medium enterprises are recognized as a 'thrust sector' by the Ministry of Industries because of the contribution of this sector in the social advancement and economic growth. Though it is highly labor intensive but still major portion of job opportunity is generated by this sector. For the balance development in all over the country it plays a vital role. As a result the standard of living in country areas is increased. Regardless of government positive attitude toward the SMEs, the performance of this sector is still below the international level. The government should persist the effort to improve infrastructure, legal framework and policy regarding SMEs financing. From the discussion it can concluded by saying that there is no doubt that SMEs are the key tool to the economic development of Bangladesh but for getting desire result it necessary that effective implementation of the mentioned suggestion and a system to monitor that effectiveness.

### **References:**

- Ahmed, Kashfia and Chowdhury, Tanbir Ahmed, (2009), "Performance Evaluation of SMEs of Bangladesh", International Journal of Business and Management, vol.4, no.7.
- AKTERUJJAMAN, S. M.(2010). "Problems and Prospects of SMEs Loan Management: A Study on Mercantile Bank Limited, Khulna Branch" Volume- V, Issue- 02.
- Alam, Md. Shamsul and Ullah, Md. Anwar.( 2006). "SMEs in Bangladesh and Their Financing: An Analysis and Some Recommendations", The Cost and Management, Vol. 34 No. 3.
- Chowdhury, Md. Shahnur Azad, Azam, Md Kazi Golam and Islam, Serajul.( 2013). " Problems and Prospects of SME Financing in Bangladesh". Asian Business Review, Volume 2.
- Helal uz Zaman, A.K.M. and Islam, Md. Jahirul.( 2011). "Small and Medium Enterprises Development in Bangladesh: Problems and Prospects", ASA University Review, Vol. 5 No. 1.
- Jesmin, Rubayat.(2009). "FINANCING THE SMALL SCALE INDUSTRIES IN BANGLADESH: THE MUCH-TALKED ABOUT, BUT LESS IMPLEMENTED ISSUE", Volume 16 Number 1.
- Mintoo, Abdul Awal.(2006), "SMEs in Bangladesh", CACCI Journal, Vol.1.,
- Report of Asian Development Bank (ADB). (2002). "Strategic Issues and Potential Response – Small and

---

Medium Enterprise Development and Export Expansion”, Asian Development Bank (ADB), Dhaka.

Shamsuddoha, Mohammad and Nasir, Tasnuba, (2011), “Micro Credit Program of Selected NGOs: An Empirical Study on Rural Poor Women”, International Journal of Educational Research and Technology, Volume 2, Issue 1.

SME Cell. (2005). “ Policy Strategies for Development of SME”, Ministry of Industries, Government of People’s Republic of Bangladesh.

The IISTE is a pioneer in the Open-Access hosting service and academic event management. The aim of the firm is Accelerating Global Knowledge Sharing.

More information about the firm can be found on the homepage:  
<http://www.iiste.org>

## CALL FOR JOURNAL PAPERS

There are more than 30 peer-reviewed academic journals hosted under the hosting platform.

**Prospective authors of journals can find the submission instruction on the following page:** <http://www.iiste.org/journals/> All the journals articles are available online to the readers all over the world without financial, legal, or technical barriers other than those inseparable from gaining access to the internet itself. Paper version of the journals is also available upon request of readers and authors.

## MORE RESOURCES

Book publication information: <http://www.iiste.org/book/>

## IISTE Knowledge Sharing Partners

EBSCO, Index Copernicus, Ulrich's Periodicals Directory, JournalTOCS, PKP Open Archives Harvester, Bielefeld Academic Search Engine, Elektronische Zeitschriftenbibliothek EZB, Open J-Gate, OCLC WorldCat, Universe Digital Library, NewJour, Google Scholar

