

Challenges of SMEs in Bangladesh

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Abstract *SMEs are accounting for 25 percent of GDP, 80 percent of industrial jobs, and 25 percent of the total labor force in Bangladesh even though the prospective sector gets negligible facilitation from different support service providers. Bangladesh SMEs have assumed special significance for poverty reduction programs and potential contribution to the overall industrial and economic growth. Although SMEs are contributing to the economy in the form of employment, supply of products and services by using indigenous technologies, social entrepreneurship, income generating activities etc. These are found most vulnerable to the macro-economic as well as internal management crises. There are many constraints in developing the SME sector in Bangladesh. Several studies have identified different constraints, ranging from access to credit to marketing their products and services. However, access to credit is considered as the main constraint. In this work existing problems and challenges of SMEs in Bangladesh are highlighted.*

1. Introduction

Small medium enterprises (SMEs) are firms whose financial requirements are too small to be effectively served by corporate banking model. SME financing is a topic of significant research interest to academics and an issue of great importance to the policymakers of Bangladesh and around the world. SMEs make

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up the largest portion of the employment base in many developing countries and, indeed, are often the foundation of the local private sector. Now the SMEs are not only concentrated to low-tech, traditional, and agro-based economic activities; these are spread over other non-traditional manufacturing and service sector as well. SMEs are considered as one of the priority sectors of Bangladesh economy since independence. Small businesses are numerous in Bangladesh and form a large majority in the domestic markets. According the estimate of BSCIC there are about 523 thousands of small enterprises including cottage industries in the country employing about 2.3 millions of people, which is around 82 percent of total industrial labor forces. These sectors are expected to offer ample opportunities to different cross sectional people of the society to get involved into income generating activities-traditional, technological, vocational and other activities and thereby strengthening the efforts towards achieving high and sustainable economic growth which are most important prerequisites for triggering an exit from vicious poverty circle. The growing economic significance of SMEs as source of development of entrepreneurship- traditional and technology social venture.

Existing definition of SME is recommended by Better Business Forum and accepted as a uniform one by Ministry of Industry and Bangladesh Bank.

Definition of the Small Enterprise can be obtained from information contained in the following.

Table 1 : Definition of SMEs

Serial No.	Sector	Fixed Asset other than Land and Building (Tk.)	Employed Manpower (not above)
01	Service	50,000-50,00,000	25
02	Business	50,000-50,00,000	25
03	Industrial	50,000-1,50,00,000	50

Source : Bangladesh Bank Report 2010.

Table 2 : Definition.

Serial No.	Sector	Fixed Asset other than Land and Building (Tk.)	Employed Manpower (not above)
01	Service	50,00,000-10,00,00,000	50
02	Business	50,00,000-10,00,00,000	50
03	Industrial	1,50,00,000-20,00,00,000	150

Source : Bangladesh Bank Report 2010.

Thus it is obvious that SMEs are not those firms/businesses which are not public limited companies and do not comply.

Definition of Medium Enterprise can be established from the criteria mentioned in the table below.

Now the SMEs worldwide are recognized as engines of economic growth where as it is one of the major tools for poverty reduction in Bangladesh. Government of Bangladesh formulated a comprehensive Industrial Policy-2005 by putting special emphasis on developing Small and Medium Enterprises (SMEs) as a thrust sector for balanced and sustainable industrial development in the country to help deal with the challenges of free market economy and globalization.

A well-developed SME sector is a pre-requisite to attaining higher growth of large-scale industry and the services sector as well. There are about 6.0 million SMEs in Bangladesh, which contribute about 50 per cent of the country's industrial output, employing about 80 per cent of its industrial labour force. SMEs are labour intensive and also need less capital. They are also significant contributors to backward linkage to heavy industries. With multilateral trade negotiations often lead to improving market access and with developing countries also being a lot more willing than before to participate in globalization, rich country government and the aid agencies have apparently decided to focus on the SMEs as one important ingredient of private-sector development.

Industrialization's link to poverty reduction is through - charging-up the growth rate of the country, enhancement of the productivity of the worker(s) in employment, providing employment to the unemployed, expanding consumer spending and thus the confidence level by sharing lower costs from scale economies via lower prices. As a result SME in Bangladesh takes several strategies to grow itself & economy of this country. Neighboring countries have also given due importance to SME.

2. Objectives

The present study focuses on the current scenario of SMEs and challenges faced by them in Bangladesh as well as suggest some policy recommendations. It is basically based on secondary data.

3. Literature review

A.K.M. HelaluzZaman (June 2011) said that SMEs are heterogeneous by their characteristics, mode of operation and types of SME products and processes.

Development of entrepreneurship, new business creation and development of inter-sectoral linkages should be given top priority. The government should define a secure and pragmatic policy for the development of SMEs in the country. The concept of public private partnership (PPP) in the sphere of development and growth of SMEs can also be explored. An enabling economic environment comprising of sound macroeconomic and structural policies, good infrastructure, fair policy of competition, and efficiently functioning financial institutions also need to be created and strengthened.

Abdul Awal Mintoo(2006) highlighted that several constraints present in SME sector in Bangladesh which gradually deteriorate the percentage of prospects.To highlight the fact that, without the introduction of suitable machinery to ensure high quality, without the enhancement of productivity and skills of workers through training and retraining, without substantial improvement in finishing, packaging and transportation systems, and without learning to switch over to e-commerce, most RMG operators will start falling behind. On this paper significant recommendations have taken place on the basis of findings.

Mahmud (2006) said that the SMEs have very limited bank finance, which is only around 10 percent, while self-finance remains the major source of their finance contributing 76.5 percent of fixed capital and 51.8 percent of working capital.

Ministry of Industries,Government of the People's Republic of Bangladesh(2005) has reported on policy strategies for small & medium enterprises (SME) development in Bangladesh where, Definition of SMEs and identification of booster sectors, national taskforce on SME development, mitigating impediments in clusters, credit-distribution package and venture capital- market, technical plan of actions and relevant quires and suggestions have been placed.

A World Bank survey (2002) on Bangladesh's SMEs identified lack of financeas the major issue, with 55% SMEs reporting it. Bribes (21%), orders/marketing ofproduct (28%), lack of knowledge (12%), and license for work (8%), along withnew technology (8%) were also considered as major issues. Without the much vitalcapital, they have little chance of growth or even sustenance in this mobile world.This study has tried to pinpoint, through empirical research, the major, problemsfaced by SMEs and banks in Bangladesh in relation to financing and has providedrecommendations based on the findings to improve the situation.

S. M. AKTERUJJAMAN (2010) elaborated problems and prospects of SMEs loanmanagement on the basis of MercantileBank Limited, Khulna Branch. The paper contained significant findings of various problems and prospects that were associated with SME loan management.

4. SME in Bangladesh

Like many other developing countries, Bangladesh has utilized the traditional “blunt” approaches to rural development, such as the “green revolution” in agriculture, which was once thought to be capable of eradicating poverty through trickle-down effects on income and employment for the poor. In the 1960s, “industrialization” was also thought to be able to absorb the surplus labor released from agriculture following ‘capital-intensive’ technological innovations, which was also failed. The policy makers failed to realize that they should develop ‘labor-intensive’ industries rather than ‘capital-intensive’ industries because Bangladesh is a labor abundant but capital scarce country and SMEs have a natural comparative advantage and it is widely claimed that relative to large capital-intensive industries, SMEs are more labor-intensive, that is they employ more labor relative to capital than large enterprises producing the similar products. Moreover, SMEs have high potential for employment generation; require much lower investment per worker compared to large industries.

Though the economic significance of the SMEs in our national development efforts has been ritualistically recognized in all the Five Year Development Plan of both pre- and post-independent Bangladesh, the sector received very little attention in terms of allocations of public investments or operational policy formulation and institution building.

SCIs were declared a priority sector for the first time in the Third Five Year Plan (1985-1990) and a set of promotional measures was envisaged to be offered facilitating their development. After a long time, SME sector has been declared as a “priority sector” in the Industrial Policy, 2004 and various measures have been initiated to help maximize the SMEs’ growth potential. Moreover, special emphasis has given to this sector in the Interim Poverty Reduction Strategy Paper (I-PRSP) of Government of Bangladesh. Despite all these initiatives, the entrepreneurs in this sector face a number of problems from initial financing of their enterprises to marketing of their final products comparing with their larger counterparts.

In Bangladesh, SMEs including micro enterprises comprise over 99 per cent of all industrial units, contributing over 85 per cent of industrial employment. Focusing on the 10+ units, small units constitute 87.4 per cent, followed by medium and large units comprising 5.7 and 6.9 percent respectively. In other words, 81 thousand SMEs all together constitute more than 93 percent of the total 10+ units. Again, focusing on the 10+ units, small units contribute to 35 per cent of the employment, followed by medium and large units comprising 8.8 and 56.0

Table 3 : Number of sample entrepreneurs by sex Figures in the parent heels are row Percentage

Type of enterprise	Number	Entrepreneurs by sex		
		Male	Female	Total
Manufacturing	30	28 (93.3)	2 (6.7)	30 (100)
Service	4	4 (100.0)	-	4 (100.0)
Business	36	34 (94.4)	2 (5.6)	36 (100)
All	70	66 (94.3)	4 (5.7)	70 (100)

Source : SME Background Study : Entrepreneurs Survey 2009.

percent respectively. In other words, SMEs employ 1.3 million people, constituting 44 percent of employment generated by 10+ units.

The recent available estimates obtained from two major micro surveys, International Consulting Group (ICG) study and South Asia Enterprise Development Facility (SEDF) survey suggest the SME contribution to manufacturing value added to be in the range of 20 to 25 percent.[6] The micro, small and medium enterprises (MSMEs) together employ a total of 31 million people, equivalent to about 40 per cent of the population of Bangladesh, aged 15 years and above. More than three quarters of the household income in both urban and rural areas are provided by the MSMEs.

There is no chance to deny the fact that Bangladesh needs a sustained level of development of small and medium enterprises (SMEs) in order to reduce poverty. Having predominance of agro-based economic activities, low level of technological development, lack of availability of highly skilled laborers, small scale businesses have been suitably developed in the country. Considering the country's level of economic growth, composition of resources or natural resources, level of international integration, and growing urbanization, industrialization there is huge scope for developing diversified and new SMEs in agriculture, manufacturing, service sectors etc. Access to finance is vital for SME sector development. In many instances, entrepreneurs raise complain regarding high rate of interest. Indeed, higher rate of interest is a major hindrance, but availability of adequate fund is very much important. That is because Bangladesh Bank is committed to facilitate SME credit through refinance window. To develop SME sector, the fund of BB, IDA and ADB is being channelized through refinance scheme. So far a total of Tk.1,432crore has been refinanced (up to

December 2009) to 14,122 enterprises using the revolving fund (Tk.918 crore) of BB, IDA & ADB. Moreover, Bangladesh Bank is going to launch an extended refinance scheme of Tk. 660 crore very soon with the newly arranged ADB fund.

Among SME enterprises/entrepreneurs in our country, small entrepreneurs have more prospects for generating employment, reducing unemployment and achieving economic growth. Keeping this in view, at least 40% of the total disbursement target of SME credit should be reserved for small entrepreneurs and the rest will be allocated to medium entrepreneurs.

Table 4 : Growth Rates of Manufacturing Industries at Constant 1995-96 prices

Year	Large & Medium Enterprises	Small Industries	Total Manufacturing Industries
1998-99	4.19	0.75	3.19
1999-00	4.35	5.80	4.76
2000-01	6.55	7.02	6.68
2001-02	4.60	7.69	5.48
2002-03 (Provisional)	6.04	8.01	6.62

Source : Bangladesh Authentic Smirking 2003, Ministry & finauce

SMEs sectors of Bangladesh

Mainly specialized textiles, block printing (manual), hand loom and handicrafts, electrical & electronics, agro processed products, leather, ceramic, light engineering, information and communication technology (“ICT”), etc., fall in the category of SMEs.

The proposed Industrial Policy 2002 recommended the following industries as thrust sectors that can contribute towards economic development and growth:

Sl. No. Name of the Thrust Sector

- Agro-based industries
- Artificial Flower Making
- Computer software and information technology
- Electronics
- Frozen Foods
- Floriculture
- Sericulture & silk industry
- Infrastructure
- Jute & jute mixed goods

- Jewelry, diamond cutting & polishing
- Leather & leather goods
- Oil & gas
- Gift items
- Stuffed Toys
- Textiles and fashion-rich personal effects.
- Tourism
- Basic chemicals/ industrial raw materials
- Dyes and chemicals used in Textile industry
- Spectacles frame
- CNG
- Wood & Steel Furniture

5. Challenges of SME

From the sequence of this analysis it has been observed the possible impacts of global financial crisis and ongoing economic recession which require a careful observation to ensure sustained and accelerated growth for the Bangladesh economy and to make poverty reduction mission successful. In this context, we need to categorize the existing challenges for the economy. These challenges are analyzed in this section.

- Non-Availability of finance hinders the growth of SMEs in Bangladesh. It is observed that 47% of the investigating entrepreneurs mention that loan granting procedures are very complex and about 13% entrepreneurs mention that their loan applications have been rejected. The remaining 40% were reluctant to take loan for their personal reasons. Hence, financial institution may try to minimize the complexity of loan sanctioning mechanism.
- Most of the entrepreneurs mention that due to the low salary structure most of the skilled employees leave SMEs.
- One of the main barriers to the development of SME in Bangladesh is inadequate technologies. Many SMEs have failed to adopt modern technology due to the shortage of adequate fund.
- Most of the entrepreneurs have mentioned that commercial banks ask for collateral at the time of granting loans. It hinders the entrepreneurs to get credit from the institutional sources.
- The loan procedure system is lengthy .It is reflected that about 46% of the respondents' mention that banks take a long time to grant SME loans. Among

the respondents 54 mention that loan application procedure is easy but 46% mention the procedure to be tough.[10]

- Numbers of institutions offering micro credit facilities are inadequate in our country.
- Some executives have highlighted that SME entrepreneurs are not properly aware about SME credit facilities.
- Inequality of opportunity is a major problem for SMEs. Female entrepreneurs are treated with discrimination. They are not well represented in business organizations. We have observed from our study that only 10% respondents are female entrepreneurs. Government and our society do not provide adequate institutional assistance and encouragement to the women entrepreneurs.
- For SMEs, owing a retail space is very expensive in the major cities in Bangladesh. As a result, many customers are not interested to buy products and services from SMEs. Because the quality cannot be judged until the products are examined.
- Inadequate government supports can be a top ranking constraint for SMEs. Unnecessary layers of bureaucracy and red-tapes are reducing the competitiveness of SMEs and raising the cost of transactions and operations. Unnecessary harassment rendered by tax or VAT collector and law enforcing agents.
- Adept with the current economic condition & achieve the desired growth in SME segment.
- Maintain the competitive edge over other players & retain the No 1 position in SME lending in an environment where there will be increased competition among existing players as well as new entrants (new banks/FIs) focusing the SME segment.
- In most of the cases SMEs in Bangladesh are not able to use the Integrated Marketing Communication (IMC) tools. But these tools play the role of important stimulus in motivating the customers and retaining them. The country does not have enough marketing capability and resources to invest in marketing.
- Most of the investigating entrepreneurs do not have adequate international exposure. To keep pace with international competition, firms face challenges to improve their products processes constantly. But in Bangladesh SMEs are

still not stressing the importance of satisfying and retaining customers by offering novel and desired benefits.

- Govt. has face difficulties to frame a national quality policy, provide adequate support systems and establish a national quality certification authority. As a consequence SMEs of Bangladesh have faced trouble to ensure the quality of their products and services both in local and international markets.
- Improve/maintain the Quality of the Portfolio.
- Imperfect market giving traders and smugglers considerable advantage over entrepreneurs.
- Inadequate human resource development programs, training facilities for entrepreneurs.
- Greater regulatory intervention in SME lending which may impact pricing and bring down revenue.
- Declining Net Interest Margin due to increase in cost of liquidity.
- Rapid liberalization & globalization.

6. Conclusion

Although the government of Bangladesh has taken some initiative in ensuring the growth of SMEs and has shown its positive attitude towards this sector but those steps are not enough at all. Bangladesh Bank has already declared 'Loan Policy For SMEs' and directed all commercial banks and non-banking financial institutions to simplify the SME Loan procedures by opening separate SME Loan Centre. At this juncture, the inferences drawn by the present study and strategies & policies suggested can be of immense interest to related parties to SMEs for giving this sector appropriate direction towards development of economy of the country. As the experiences of SME finance in Bangladesh suggest, there is critical need for putting in place a credit delivery system that evaluates the credit worthiness of borrowers, on a basis other than fixed asset ownership. The evaluation may require examining transaction records of the borrowers, assessing the value of movable assets etc. There will also be the need for enhanced post disbursement monitoring. An effective SME finance policy will have to cover such enhanced cost of credit administration. In addition to credit guarantee or refinancing facility there will have to be adequate rediscount facility for the primary lender to accommodate these costs. Such credit line also needs to be made available to non-bank institutions such as the NGOs. Since the SME financing has been identified as a major obstacle to SME growth, the financing scheme should

also include special provisions for women entrepreneurs. Indeed, the implementation of appropriate policies and strategies is a prerequisite to harness sustainable competitiveness of SMEs around the country. Suggestive remarks have been stipulated in this write up. With that paradigm, proactive policy is essential to enact them. The first step in this regard is to make firms fully aware of the competitive challenges they have to face. The next step is to help SMEs prepare to meet the challenge by understanding their strengths and weaknesses and providing the inputs they need to help them upgrade. Having ensured above those there will be remained big issues such as social and political instability and infrastructure. Paying the concern equally on to the challenges, SME sector can be the leading economic strength of Bangladesh.

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