

Alternative Financing for SMEs¹

SMEs all over the world have an important role to play in industrialization and economic growth and thus creating employment as well. It promotes inter-sectoral linkages, raising exports and develop entrepreneurial skills. It has important advantage in reducing regional imbalances. The future of SMEs is of major policy concern for reshaping industrial sector performance. SMEs and their contribution to economic growth, social cohesion, employment and local development are no doubt recognized by every quarters.

SMEs account for over 95% of enterprises and 60%-70% of employment, and generate a large share of new jobs in OECD economies. While International Monetary Fund(IMF)² indicated that SMEs in Bangladesh accounted more than 99% of private sector industrial establishments and created job opportunities for 70%-80% of the non-agricultural labour force. The share of SMEs production value added to gross domestic product(GDP) ranged between 28% and 30% . The contribution of SMEs to national exports is significant(ADB-Asia SME Finance Monitor 2013). There remain problems in calculating numbers also, estimated number of SMEs in Bangladesh varies from 6m (an estimate from ADB including micro and SME) to the 3.3m as registered SMEs in the country. As globalization and technological change reduces the importance of economies of scale in many activities, the potential contribution of smaller firms is enhanced. But SMEs need to know how to enter into the global value chain in order to sustain and be competitive.

Though the word SME is one of the buzz words but in the statistics there is as such no existence of SMEs, in the Bangladesh Economic Review prepared and published by the Ministry of Finance during the announcement of Budget every year, industrial contribution of large and medium are shown together while the contribution of small industries are shown separately, so there is no way to get SMEs contribution to the GDP. As per Economic Review 2014³, contribution of Large and Medium Industries(LMI) to GP is 13.73% while the contribution of small alone is 5.23% in 2011-12. The figure of the same was 11.29% and 4.68% in 2002-2003 respectively. The statistics reflects that contribution of small industries increased only 0.55% during these last seven years which is minimal, while the contribution of large and medium has increased by 2.44% .

Size of industrial establishments is measured based on employment or capital. Definition of Industrial Policy is the basis for defining the SMEs. There are of course variations of defining SMEs because of different reasons. Bangladesh Bureau of Statistics(BBS) defined SMEs for preparing census, National Board of Revenue defined SMEs to extend tax benefits, Banks follows their own criterion in defining SMEs for extending loans, of course Bangladesh Bank in a circular mentioned that Industrial Policy definition would be their basis in defining the SMEs. In calculating industrial loan by Bangladesh Bank, LSI, MSI and SSI are shown separately which of course gives a picture of financing to these sectors.

We are expecting a new Industrial Policy in 2015, there might be some changes in defining different industrial classes at the same time some new definition for Handicrafts, Venture Capital(VC) may be included as like as in the Industrial Policy 2010 where definition of Micro Industries, Women Entrepreneurs, High Tec industries were included for the first time.

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² International Monetary Fund(IMF), 2012, IMF Country Report No12/293 as referred in Country Review-Bangladesh, ADB, Asia SME Finance Monitor 2013

³ Bangladesh Economic Review 2014, P-289

SMEs in the country are suffering from several problems of which financing is the most important, sometimes SMEs are termed as missing middle as they have limited access to formal sector financing, there is absence of new and innovative credit schemes and financial instruments in order to accelerate the flow of funds for SMEs. Along with the financial constraints, they have less access to technology, because of absence of scale they can not establish market linkage, and are not equipped with adequate business support services .

For addressing the SME Financing constraints include some of the countries introduced Credit guarantee funds, Venture capital, Leasing, Group-based and mandatory lending, Credit Surety Fund Scheme, Supply Chain Lending Scheme, Factoring and many others.

Financing scenario in some Asian countries

As like as Bangladesh case, SMEs are the backbone of the Asian countries, accounting for about 98% of all enterprises, and 66% of the national labour force on average 2007-2012⁴. According to the study by ADB generally, SME access to banks have gradually improved because of various government support measures such as credit guarantees and mandatory lending etc, the table below can give a clear picture:

Year	Countries	Amount(% to GDP)
2012	Republic of Korea	38.9%
2013	Thailand	33.7%
2012	Malaysia	20.1%
2013	Cambodia	7.8%
2012	Bangladesh	6.7%
2012	Kazakhstan	4.7%

Source: ADB Asia SME Finance Monitor, p-9

The statistics above shows that, in Bangladesh even though about 99% of the total enterprises are SMEs, the access to finance from banks is much lower than other Asian countries except Kazakhtan. It clearly gives us a signal that Bangladesh needs to improve the financing situation for SMEs to a large extent. In Korea, Thailand, Malaysia contribution of SMEs to the GDP is much higher than that of Bangladesh.

SME Financing Scenario in Bangladesh

Arrangement for Funding for Industries⁵

As like as Asian countries, government of Bangladesh has given enough thrust for increasing SME funding but because of absence of clarity in some cases, unwillingness of the Banks and Non-Banking organizations the financial system for SMEs are skewed and SMEs have to shuttle here and there for getting access to finance, Bangladesh Bank has strong directive for opening SME Branches, separate provision for loans and many other positive policies but in reality, financing system for SMEs have not been improved up to the required level. As has been available in the website of the Bangladesh Bank, following three broad fragmented sectors are available for financing SMEs:

1. Formal Sector,
2. Semi-Formal Sector,
3. Informal Sector.

Formal sector: The sectors have been categorized in accordance with their degree of regulation. The formal sector includes all regulated institutions like Banks, Non-Bank Financial Institutions (FIs),

⁴ ADB Asia SME Finance Monitor, 2013, p-5

⁵ Bangladesh Bank Website

Insurance Companies, Capital Market Intermediaries like Brokerage Houses, Merchant Banks, Micro Finance Institutions (MFIs)⁶ etc.

The Semi Formal Sector: The semi formal sector includes those institutions which are regulated otherwise but do not fall under the jurisdiction of Central Bank, some of these are; Insurance Authority, Securities and Exchange Commission or any other enacted financial regulator. This sector is mainly represented by Specialized Financial Institutions like House Building Finance Corporation (HBFC), Palli Karma Sahayak Foundation (PKSF), Samabay Bank, Grameen Bank etc., Non Governmental Organizations (NGOs and discrete government programs.

The Informal Sector: The informal sector includes private intermediaries which are completely unregulated and unregistered in most of the cases.

It is of course true that, percentage share of SME financing in these above three sectors is not very clear to us, but it is fact that because of stringent formalities, SMEs prefer to be in the informal sector and remains mostly in the extra-legal situation causing a serious risk for themselves.

Some statistics below can give us share of SME loans provided by the Banks⁷:

Industrial Term Loan

Taka in crore

Period	Disbursement				Recovery			
	LSI	MSI	SSCI	Total	LSI	MSI	SSCI	Total
FY 2011-12	21918 62.13%	10969 31.09%	2392 6.78%	35279	17979 82.03%	9916 90.40%	2342 97.91%	30237
FY 2012-13	27955 65.73%	11574 27.65%	2999 7.05%	42528	24288 86.88%	9468 81.80%	2794 93.16%	36550
Jan-March 2014	6054 65.21%	2331 25.11%	899 9.68%	9284	6976 115.23%	2087 89.53%	747 83.09%	9810
April-June 2014	7650 66.74%	2848 40.55%	965 8.42%	11463	7023 91.80%	2359 82.83%	797 82.59%	10179

Source: Bangladesh Bank

Loan disbursement in the Large Scale Industries(LSI) is 62.13% of the total, Medium Scale Industries(MSI) and Small Scale and Cottage Industries(SSCI) together received 37.87%, about two thirds of the total banking finance goes to the LSI. In the year 2012-13, the situation rather deteriorated in favour of SMEs, share of LSI improved and reached to about 66%, remaining 34.65 goes to the MSI and SSCI.

In case of overdue and outstanding, the scenario is opposite:

End of June 2014	Overdue				Outstanding			
	LSI	MSI	SSCI	Total	LSI	MSI	SSCI	Total
	5936	3965	1006	10907	69621 69.35%	24695 24.60%	6079 6.06%	100395

⁶ Bangladesh Bank

⁷ Bangladesh Bank

Outstanding for LSI is the highest about 70%, while in the SSCI it is the lowest to about 6.06%. There could be some details of the statistics to help understanding the actual situation if number of industries, sectors are mentioned along with the above statistics. Banks are willingly reluctant to provide loans to the SSCI sectors even though their single requirements are much less than the LSI, in order to avoid administrative costs and risks, Banks are reluctant to finance SMEs.

Funding for SMEs are still bank centered, however, non-banking financing is also there to fill the gaps. In Bangladesh non-bank financial institutions(NBFI), such as leasing, factoring, invoice discounting, and equity investment are in place. Besides, like other Asian countries Micro Finance Institutions, venture capital funds, capital market financing, equity finance, corporate bond issuance, and mezzanine financing and various other financing models are available.

Types of Funding for SMEs

Usual financiers in Bangladesh for SMEs are mostly NGOs, Govt. Banks, Capital Market, Friends and Family, etc, problems of getting financing are different from different sectors while usual financing from Banks is a problem for SMEs. Banks are opening SME branches to fund the SMEs. Business firms go to banks to solve their financing problems. Banks provide different kinds of loan products according to the need of business firms as per regulations of the Bangladesh Bank.SME credit policy and programs, sector-wise target based lending to disburse in manufacturing sector by banks and financial institutions as per advising of Bangladesh Bank, service sector and women entrepreneurs, priority to women entrepreneurs for disbursing more credit, refinance scheme for agro processing industries have helped a lot to develop the SME industries in the country.

There are collateral free loans, but commercial banks mostly practice of giving loans against collaterals. Sometimes amount of collaterals are higher than the loan. SMEs are one of the worst sufferers for getting funding against collaterals, with this, extremely high interest rates causes serious barriers for collecting funding from the banking sources. Problems of getting funding varies from sector to sector and different financial institutions, non-traditional industrial sectors including ICT firms are the most sufferers, as they can not show collaterals as required amount.

Thus SMEs are mostly engaged in high risk businesses, food processing industry, ICT industry, livestock industry are some of the good examples to present the risk associated with SMEs. A poultry firm can be ruined within a night, ICT firm can be stopped because of not developing sellable software. Also the SMEs cannot ensure the secured flow of profit, as a result, they cannot ensure regular payment of installments. Banks never want to increase the risk by financing such a kind of risky business. SMEs are unaware about their own value chain, as they have to develop their own, so their scale of production is limited and sometimes fail to respond to the demand, specially external demand, if there is any.

SMEs usually starts with small capital and they provide unique types of products to some extent. As their market share is small, they can not produce much. Generally they don't generate good profit in the beginning. So the startup SMEs remain less profitable. Banks and financial institutions do not support to graduate SMEs from small to a large one, so banks are unwilling to finance the SMEs.

Bank rarely calculate the risk factor to enable the firm to sustain in future and pay the installments. If a bank has the ability of forecasting a firm's future, it should not have problem in financing the firms who don't have enough collateral. It is a matter of surprise that both domestic and international private commercial banks lacks skilled human resource to assess credit risks under uncertainties. Also the monitoring and management cost for such loan is also high. As a result bank charges high interest rate which is not viable for the sustainability of a venture. SMEs are in a vicious circle of low finance-low business-low profit-low return loop.

Capital Market as a funding source for SMEs

In Bangladesh, so many non-government organizations are running their operation. But the size of loan they provide is not adequate. Loan repayment terms & conditions and interest rate is not friendly to the small and medium enterprises.

Capital market is a good place to raise capital. But in collecting fund from capital market is not easy and fast way. Recent financial crisis has made the entrance of new firm in capital market lengthier. To go to capital market, a firm has to submit some documents including audited statements. As SMEs are unsafe and small ventures, they face more trouble in getting listed. So raising fund through capital market is not favorable for SMEs.

Two capital markets are operating in Bangladesh, these are Dhaka Stock Exchange(DSE) and Chittagong Stock Exchange(CSE). DSE established in 1954 has 547 listed companies and market capitalization is BDT 3.2 trillion⁸ as of December 2014. CSE established in 1995 has 257 listed companies with market capitalization of BDT 2.6 trillion⁹ as of December 2014. These markets are supervised by Bangladesh Securities and Exchange Commission. SMEs are almost excluded from applying in the Capital markets as the minimum paid up capital requirements is BDT 100million in DSE and BDT 10 million in the CSE.

In Bangladesh, as such no SME Exchange is in place, to raise funds from the capital market. In India, in response to the recommendations of the prime Minister's Task Force, two dedicated SME exchange were launched in 2012. The Philippines launched the SME Board under the Philippine Stock Exchange in 2001. While in Malaysia and Thailand, there are no dedicated SME Exchange, but there are markets that SMEs can tap. In Vietnam, the Hanoi Stock Exchange has a trading venue for unlisted public companies, named UPCoM, which was established in 2009, there is no listing fees for UPCoM. Indonesia has no SME capital market but preferential treatment are given to SMEs to tap Indonesia Stock Exchange market¹⁰.

In Bangladesh most SMEs are typically excluded from even applying for listing in the exchange markets of Bangladesh because of minimum paid-up capital requirements and stringent formalities. There is no specialized SME capital market in our country. Some work is going on, one idea is that existing over-the-counter (OTC)market is recognized as an SME Exchange under the Dhaka Stock Exchange¹¹, the issue needs a lot more discussion and research.

EEF and Venture Capital for SMEs

To develop and set up new IT companies / subsidiaries in IT and Agro sector, Equity & Entrepreneurship Fund(EEF) was established with the amount of BDT. 100 croer in the 2000-2001 budget. This initiative was taken to develop the rural business and the small enterprise in that sector. After the launching, Bangladesh Bank took the main responsibility to initiate this project. On April 16, 2009 Bangladesh Bank gave the responsibility of EEF to ICB as a sub agent after granting permission from the Ministry of Finance. All the EEF related rules, implementation and monitoring are done by EEF unit of Bangladesh Bank. The amount EEF granted for different project is BDT 2700 Crore and the released amount from Ministry is BDT 1225 crore as of information received up to 2013¹². So far the number of EEF project extended to agro sector is much higher than that of ICT, where as ICT need funding for long time. In the agro sector also, all types of products are not allowed

⁸ DSE Website

⁹ CSE Website

¹⁰ ADB SME Finance Monitor 2013

¹¹ ADB SME Finance Monitor, 2013.

¹² In house Research of BUILD

to get EEF benefits, some promising sectors like potato chips, multi-sectoral cold storages are excluded from getting EEF funding because of its unreliable nature.

In the BUILD's study on EEF and ICT Financing, it is seen that Entrepreneurs Equity Fund (EEF) has got several loopholes and not availed by many. Though it seems like Venture Capital, but as Banks or Financial institutions and Government is not liable to bear any loss, for this reason categorized as Equity Fund. As the companies have to be registered as a Private Limited Company according to the 'Companies Act 1994' and have to issue Share Certificate by the total EEF amount in the name of the Government of Bangladesh. As ICT entrepreneurs cannot float in the Capital Market because the threshold to qualify for 'IPO' is high. So, before granting the EEF amount, BB takes an Undertaking from the company that they have buy-back the shares from their personal account.

In the latest policy, it is mentioned that the company has to issue Share Certificate in the name of The Government of Bangladesh by the total amount that has been granted. But in the EEF (ICT) Fund Consumption Policy of 2009, there was the system to issue Share Certificate based on the installments. The entrepreneurs should have the choice that whether they want to mortgage the total share or they want to make as per installment.

The amount of EEF support for ICT is maximum Five crore, of which 51% has to be the equity of the entrepreneur. But the disbursement of the installment takes one and half year. Before that, the evaluation of ICB and Lien Bank or Financial institutions also takes much time. IT entrepreneurs need sufficient breathing time to start buy-back. Also to note, the net profit margin after covering all the overhead expenses may not be sufficient to allow buy-back if these time constrains remains same.

As per EEF policy, after the completion of 8 years timeline of EEF support, the share amount will be transferred into loan. And the interest rate is determined by Bangladesh Bank. But the entrepreneurs want to know the interest rate before they take the first installment. There should be a mechanism to determine the interest rate, which will be same for all and entrepreneurs should be informed about it before they start taking the EEF support.

In order to make the entrepreneurs (especially ICT firms) more compliant and accountable to run their companies as per EEF policy, the exchange of information among all concerned including companies, Bangladesh Bank, Lien Bank, ICB is necessary. According to revised EEF Policy, they should call a meeting in every three months and the Nominated Director will give a report based on this. But this provision is not followed by the entrepreneurs.

Refinancing scheme of Financing SMEs

Bangladesh Bank has opened a new department SME & Special Programme Department(SMESPD) on December 31, 2009 so that financing to SMEs can be strengthened. The main objectives of the department is to create an enabling environment for the SMEs; priority to cottage; micro and small entrepreneurs; priority to the labour-intensive, value added and employment generated sectors; support to the women entrepreneurs; use of modern technology for SME banking and financing; supporting SME financing establishing a Information storage; increase involvement of Bank and Financial institutions for entrepreneurship development etc.

Refinancing is one of the important supports extended by the Banks for financing SMEs. Refinancing Scheme for Small Enterprise sector allowed as per circular of the Bangladesh bank in the year 2004¹³ extended in the year 2007 allowing women entrepreneurs to get loans at Bank rate plus five percent. These type of financing are enterprise driven, objectives of which is to support entrepreneurs so that Bangladesh Bank can suggest a fixed rates to the disbursing banks. Besides, there is a funding from JICA and ADB for supporting SMEs, interest rate of which has been determined at the market rate and distributed through different banks. These financing are mostly Banks driven as they can fix the

¹³ Circular 1, 2014

interest rates based on the demand and supply of the markets. In the year 2010 another circular¹⁴ from Bangladesh Bank was issued for refinancing the agro-sector specially which are established in the rural areas, A new refinancing scheme has been issued in the year 2014 for supporting new entrepreneurs. The latest refinancing circular has been issued in the name of Islamic refinancing scheme in the October 2014 for funding SMEs.

Beyond these refinancing scheme, banks are free to set their interest rates within the band circulated time to time by the Bangladesh bank, the highest band remains with in 15-16%.

There are different opinion and analysis among entrepreneurs regarding getting financing from banks where there is a usual claim that SMEs are the worst sufferers for getting funding from the Banks. It is always argued that Banks charge higher interest rate to cover the risk of collateral-free investment.

Other Alternatives of Financing

Mezzanine Financing: Private Equity(PE) markets have been increasing steadily in the Southeast Asian countries, Mezzanine Financing is a different form of financing driven by demand for growth capital from company owners that want to avoid equity dilution¹⁵.Mezzanine financing is basically debt capital that gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back in time and in full. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies. Since mezzanine financing is usually provided to the borrower very quickly with little due diligence on the part of the lender and little or no collateral on the part of the borrower, this type of financing is aggressively priced with the lender seeking a return in the 20-30% range(Source Internet). Growth of PE was tremendous, increased from 2.6% of 2006 to 10.6% in 2012 in Southeast Asia¹⁶. Some funds are starting to provide mezzanine financing, albeit on a limited scale. SMEs are mostly suffering from insufficiency of capital supplied by Banks, Mezzanine Financing could be a source of financing, but as they are also not enough experienced in negotiating complex deals, so for the risk management issues Banks and Parent Companies should come forward to support SMEs and be well qualified with adequate legal provisions.

Venture Capital Firms

SMEs are facing problems in financing themselves by the present financing solutions. Venture Capital(VC) has come forward to solve these problems. As SMEs lack expertise knowledge in the field of accounting, marketing, financing and management, VC firms not only finance the firms, but also provide support in these areas. As they are partly owner of the SME, they try to make the firm profitable so that they can get the share of profit.VC firm provides a win-win situation between the investee firm and the VC firm as it provides capital required by the risky investee firm and enjoys ownership rather than being creditor in return. Investee firms don't face problem of strict installment payment schedule (bank financing) because VC firms participate in profit. And they will sell the ownership either to the investee firm or to the 3rd party according to the agreement which will not put pressure on the investee firm.

Venture Capital is new to the people of Bangladesh. As interest is not applicable for this kind of financing, entrepreneurs feel interested. But when they come to know that investor firm will participate in profit, they are discouraged because they don't want to share profit with anyone¹⁷. At present, there is no legal framework for the VC firms. Some firms started providing venture capital,

¹⁴ SMESPD Circular

¹⁵ Private equity Market in South Asia, Takeshi Shimamura, December 10, 2013

¹⁶ Ibid

¹⁷ In house research of BUILD

but they don't have enough legal support because of unavailability of law, rule and regulation regarding VC. The situation in India is different, the Securities and Exchange Board of India (SEBI) has prepared SEBI Venture Capital regulations 2006 in India, Ministry of Finance issued a Guidelines for Overseas Venture Capital, also they have the Central Board of Direct Tax Guidelines for Venture Capital Companies 1995 (amended in 1999)¹⁸. Bangladesh is in a serious need for a legal statute for Venture capital companies.

VC firms provide technical assistance in managing the businesses to ensure sustainable growth of established companies. If loss is incurred, VC firm also share loss with the investee firm. VC firm makes a partnership agreement with the investee firm at the beginning of investment. After the specified period of investment, VC firm offers the investee firm to buy back the ownership at predetermined price. If the investee firm doesn't buy back the ownership, VC firm can sell it to 3rd parties. Selling the ownership over an Initial Public Offering can be an option if SEC regulation allows them to do so. But at present, it is not possible because minimum value of IPO is so high. There are

A Joint Venture¹⁹ company is a temporary partnership formed for carrying a particular venture. In law, joint ventures are regarded as partners. Joint venture doesn't use firm name and is a short term partnership business. Joint ventures can't be sued (Basu, 93). A SME, financed by venture capital, runs on going concern basis and has unique firm name. After certain time, VC firm can sell its ownership, but the investee firm can run for foreseeable period of time.

Musharaka and Mudaraba are the two types of Islamic investment. Under Musharaka system, Islamic investor makes a joint venture with another business entity, each with assigned responsibilities. Profit and loss are shared according to the agreement. This venture is an independent legal entity and the Islamic investor has the option to exit the business after certain period. Under Mudaraba system, the Islamic investor contributes the finance and the client provides the expertise, management and labor. Profit is shared according to the agreement. But only bank is liable for the loss (Ali, 2006)²⁰.

Some firms have started operation and they claim that they are providing venture capital. Venture Investment Partners Bangladesh Limited (VIPB) established with an objectives of developing SMEs. VIPB provides various direct equity and quasi-equity funding schemes, ranging from as low as TK 300,000 and above to the under-served SME ventures throughout the country. VIPB also provides assistance in marketing, management and accounting sections of the investee firm.

BDVL is a new venture capital firm in Bangladesh established with an objectives of investing and incubating new and existing business ideas in emerging and high-growth sectors where funding is not adequately available. Asian Tiger Capital Partners (AT Capital) is one of the first financial institutions in Bangladesh focusing on Asset Management, Corporate Advisory and Macro-Economic Consulting. SEAF Bangladesh Ventures (SEAF BV) is established to provide SMEs with structured capital and quasi-equity investments. Brummer & Partners is an international firm. This firm has started operation in Bangladesh with several million dollars. Brummer & Partners Asset Management Bangladesh Limited is seeking for new investment opportunities.

Though no regulatory policy for venture capital firm exist, VC firms can't offer banking product. So this type of investor firms can only invest in those industries where banks and financial institutions will not invest. Banks are less interested in vulnerable sectors. Government has set the target that banks have to ensure 2% of their investment portfolio in vulnerable sectors. If any bank fails to do that, Bangladesh Bank (BB) cuts off the money from Cash Reserve Ratio (CRR) to the level of money not invested in vulnerable sectors. BB refunds the money next year, if the bank gives loan to vulnerable sectors to the level BB has cut off the money from CRR in previous year.

¹⁸ ADB Asia SME Finance Monitor, 2013, P-61

¹⁹ Internship Report of Mr MD Tasnim Fahmi, BUILD, 1-1-2013

²⁰ Ibid

But still, there are a lot of SMEs who are not considered for providing loan. VC firms in Bangladesh invest mostly in ICT industry, food processing and beverage industry, light engineering industry, agro industry, renewable energy industry and tourism industry. Bangladeshi software development firms have high growth potentials, but they can't work on big projects because of lack of capital.

Regulatory issues for flourishing VC: No definition of venture capital is present in Bangladesh, so there is no criteria of becoming a venture capital firm. As no regulatory framework and regulation are present, VC firms are facing problems in running business operation. To start business, the VC firms take No Objection Certificate (NOC) from Bangladesh Bank (BB) first which assures that VC firms will not get engaged in banking or financial products. Then, they take NOC from Securities and Exchange Commission (SEC). After that, they register with Registrar of Joint Stock Companies and Firms (RJSCF). VC firms can't do any fund raising activity. For business purposes, VC firms use Contract Act 1872, Negotiable Instrument Act 1881.

As venture capital firms take NOC from BB, it can't collect public money and raise capital like banks. So they run business by their own money. Also investment by the foreign investors is not allowed. So many foreign individuals have showed their interest to the present Bangladeshi VC providers, but this is not possible to bring their money because of restriction.

PE Investors are not encouraged by policies as like as Eligible Institutional Investors (EII)

Bangladesh Security Exchange Commission(BSEC) categorizes Eligible Institutional Investors (EII), under Securities and Exchange Commission (Public Issue) Rules 2006, includes the following stakeholder groups (clause 6b of BSEC Notification dated October 5, 2011); Merchant Bankers, Commercial Banks, Asset Management Companies, Non-Banking Financial Institutions (NBFIs), Insurance Companies, Stock Dealers.

According to clause 14 of the same Amendment²¹ to Public Issue Rules 2006, Lock in period for EIIs is four months, compared to 3 years for PE Investors. **“Clause 14: Lock in-** There shall be lock-in of 4 (four) months from the first trading day on the security issued to the eligible institutional investors.”

Many countries within the region have eased this provision for PE investors, to encourage strategic investors who were previously deterred by lengthy lock-in periods. In Sri Lanka there is One year Lock-in period for the sales of shares held by Private Equity investors, from the date of allotment of such shares. In India, One year Lock-in period for all PE investors, compared to 3 years lock-in period applicable for other promoters, Lock-in period of 6 months for pre-IPO investors provided they adhere to a set of conditions In Hong Kong, In China, One year Lock-in period for investors that buy stakes in companies up to 12 months before flotation.

The rule (of imposing a lock-in period) does not address the differences in objectives and operations of promoters and equity investors. And given how regulators are keen to stop unscrupulous cash-in from IPOs, there should be policies and legal mechanism in place to identify the PE funds or their investments as separate from the overall capital market (like EIIs).

Classifying all types of investors under one roof does not provide equity investors suitable grounds for exercising IPO as an exit route. Provisions could be made to segregate PE Investors from general sponsors of a private limited company, so that they are not subjected to the lock-in of 3 years²².

²¹ Amendment to the Securities and Exchange Commission (Public Issue) Rules 2006, through BSEC Notification dated October 5, 2011

²² In-house research of BUILD

Concluding Remarks

SMEs are facing a number of challenges which are interrelated and sufferings for funding and high rate of interest is one of the long-standing challenges. From the report it is viewed there are a number of alternatives available for financing SMEs, countries based on their own regulations, policies offering funding for SMEs, legal statute for each sector is very important. Required institutional support along with qualified investors, e.g., banks, capital market experts, endowments and foundations, government agencies, corporations, fund of funds, insurance companies, asset managers, pension funds or sovereign wealth funds can be used for SMEs if the legal provision are really effective, workable and supportive for SMEs.

From the statistics of financing to SME from the source of Banking and Non-banking in the year 2012 it is seen that number of SME borrowers were .46 million(small and cottage was .35 million and .11 million medium), among which the number manufacturing firms were only .16 million while most of the firms, i.e. .29 million are from trading sector, remaining .01 million from the services sector enjoyed the funding. It shows that whatever funding were made, a significant proportion went to the trading sector. On the other hand SME loans enjoyed by the urban(BDT 512,986million) areas are much higher than that of the rural(BDT 184,553 million)areas in 2012. The tradition is still in practice. In order to address the issues of SMEs, an integrated supporting plan is required for which full coordination among different SME supporting organizations is also required.

In order to get a solution from the above, diversification of financial models is definitely a prescription, at the same time following could be a necessity:

1. Banks should be encouraged to invest in the risky ventures with a soft terms and conditions.
2. Compulsory limit of Banks to invest in the vulnerable sectors should be maintained strictly.
3. Along with other definition, there could be a definition of venture capital firms in the upcoming Industrial Policy 2015 in order for creating a statute for VC firms.
4. Venture Capital Regulations in line with the Securities Exchange Board of India(SEBI), Venture Capital regulations 1996 can be framed so that already established VC firms can get a directives to move further.
5. Small Exchange in line with Koreas KOSDAQ and similar other Asian countries can be an example for Bangladesh. In the mean time OTC market, if can be used as an SME Exchange can also be planned.
6. Factoring is working in the country at a domestic level, there is a need for preparing a Factoring Policy .
7. Cooperative Banks are working in India, most of them are operating in the rural areas, Bangladesh should think how to enhance financing facilities in the rural areas, where Bank branches are limited.
8. Refinancing facilities in different new subsectors and non-traditional sectors should be increased.
9. Terms and conditions of Refinancing facilities supported by different donor organizations should be examined carefully before approving these type of schemes to make it really workable for SMEs.
10. Funding from the non-bank financial institutions are gradually increasing even though their interest rate are a bit higher than the finance from Banking as the NBFi repayment terms are sometimes benign than the banking sector. NBFi should be encouraged to extend funding in the new segments and against diversified set of collateral.
11. Once IFC introduced Collateral Registry as one of the options for securing loans for the SMEs, we need to revive the system and follow up of the project is important.
12. EEF in Bangladesh Bank should work properly for ICT and other non-traditional sectors, in that respect BUILD provided some recommendations could be helpful if implemented.
13. Regulations for Private Equity could be made simple to ensure funding for business entrepreneurs.
