



International Journal of Physical and Social Sciences

(ISSN: 2249-5894)

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Title

**SMALL AND MEDIUM ENTERPRISES (SMES): A
PROMISING SECTOR FOR SUSTAINABLE
DEVELOPMENT IN BANGLADESH**

Author(s)

Md. Nazmul Haque

M. Phil Fellow,

Department of Economics,

Islami University, Kushtia, Bangladesh

ABSTRACT:

Poverty alleviation and sustainable development have become burning issues all over the world now-a-days. A significant development of a nation means proper alleviation of poverty and sustainable development. For this reason poverty alleviation and sustainable development have become global challenges, especially in the developing country like Bangladesh. The micro credit programme is playing a vital role in the poverty alleviation. But it is not sufficient for sustainable development. There is no alternative way as Small and Medium Enterprises sector (SMEs) for sustainable development. For this reason SMEs is an emphasizing sector not only developing country like Bangladesh but also all over the world. In parallel of government of a country, commercial banks and economical institutions have initiated different activities on the basis of SMEs sector to gain sustainable development. In this article we have investigated the role of SMEs sector to sustainable development in Bangladesh. Our main objective in this paper is to study and analyze the activities of Government, commercial banks and economical institutions in the small and medium size enterprises (SMEs) in Bangladesh. This paper focuses the employment status of the small enterprise sector and the progressive status of Medium enterprise sector in Bangladesh and also based on mainly secondary data.

Keywords: SMEs, Sustainable development, Poverty Alleviation, Commercial Banks

INTRODUCTION:

It is generally recognized that SMEs have a significant role in employment generation, poverty reduction and over all economic growth, especially for a developing economy like Bangladesh. A combined interaction of the forces of product-mix, locational factors, technological advantages and market advantages create opportunities for SMEs to grow and prosper at all levels of development which are often ignored by the traditional approach to their economic strengths and development potentials [5]. Small and Medium Enterprises (SMEs) are the dominant form of business organization in all countries, typically accounting for over 95% of the business population [17]. Organization of Economic Cooperation and Development (OECD) recognized that SMEs constitute an important dynamic element in all economies as they drive innovation,

especially in knowledge-based industries; and play a key role in driving sustainable economic growth, employment creation and poverty reduction, especially in developing countries. It also contributes to the social, cultural and environmental capital of nations [12].

SMEs are typically labor intensive industry with relatively low capital intensity. As such for a country like Bangladesh which is a labor abundant and capital scarce, SMEs have a natural comparative advantage. In recognition of the strategic importance of the development of SMEs in promoting industrial growth, employment generation and poverty alleviation the SME sector has been declared as a priority sector in the Government's industrial Policy 2003 and various measures have been initiated to help Maximum the SMEs growth potential. Availability of finance is thought to be a major constraint to formation and growth of SMEs in Bangladesh [4]. Banks are reluctant to expand their SME credit portfolio because they do not consider SME leading in an attractive and profitable undertaking. This is so because SMEs are regarded as high risk borrowers because of their low capitalization, insufficient assets and their inability to comply with collateral requirement of the banks [17]. Administrative costs are also higher because close monitoring and supervision the SME operation becomes necessary. Therefore this is difficult to finance SMEs by the formal market such as commercial banks in Bangladesh. Nevertheless, commercial banks in Bangladesh have been more enthusiastic now- a- days in financing the SMEs since this seems more profitable coupled with high risk as well. In the recent years, Bangladesh has seen boom in the SME sector due to easier accessibility to the formal credit market [9].

Rational of the study:

The development of SMEs sector depends on mainly banks' financing. Due to the cost, low recovery rate and high price chargeable involved in SME financing, formal credit market especially commercial banks traditionally is reluctant to serve the SME sector. But in the recent year, many commercial banks have opened up their wings for SME financing. They have developed their own products and production technology that mitigate the risk and cost involved in financing the SMEs [9]. Since the traditional understanding is financing the SME is quite difficult and costly for formal credit market especially for commercial banks and also that SME sector clients may not afford the price for these products, the recent year's growth in credit

outreach become extremely and interesting area of study. From the supply side, this very interesting to assess and examine why commercial banks have gone into the SME financing activities breaking the traditional understanding, how they have design their products and production technology to mitigate all risk and costs involved in financing and also what factors and creating building blocks in further development [6]. A historically accelerated pace of trade liberalization in Bangladesh since the early 1990s by spurring a veritable deluge of imports has quite significantly increased competitive pressures on SMEs in Bangladesh. Rapidly falling cost of communications have by unifying global markets heightened the intensity of competition. Trading is widely seen as a safer, richer, smarter and bulkier career to have than manufacturing - bad news indeed for industrialization. With this end in view, Government of Bangladesh formulated the National Industrial Policy 2005 (NIP,2005) by giving special emphasize for developing Small and Medium Enterprises (SMEs) as a thrust sector for balanced and sustainable industrial development in the country with the vision for facing the challenges of free market economy and globalization [14]. In meeting this thirst, this study area of SMEs has been chosen.

Objectives of the study:

The main objective of this study is to examine the process of booming development of commercial Banks and other economical institutions financing for SMEs in the current period. A set of objective that will govern this study is stated bellow:

1. To examine the historical perspective of SME financing of the commercial Banks and other economical institutions.
2. To evaluate how SME financing helps to create new employment in the commercial Banks and other economical institutions.
3. To examine why commercial Banks and other economical institutions have come to finance in the SME sector.
4. To evaluate the SME financing of the commercial Banks and other economical institutions.
5. To provide policy recommendations for SME financing base the findings of the study.

Methodology:

This study is naturally descriptive. Data used this study are collected basically from the secondary sources. Primary data are also collected through personal interview method conducting the person who is supposed to have knowledge about the matter .Secondary data has been collected from various sources including websites, newspapers, annual ADB reports, prospectus, product information papers etc. Direct interview and hand on working with the Government and non Government commercial Banks SME division has been conducted to gather necessary data and information. The study will be a qualitative study based on the collected data and information and involves limited scale numerical and financial analysis.

Definition of SME

Following the National Industrial Policy 1999 (NIP,1999), “Small Industries” are defined as industrial enterprises employing less than 50 workers and/or having a fixed capital investment of less than BTD.100 million “Medium industry” covers enterprises employing between 50 and 99 workers and /or having a fixed capital investment between BDT. 100 and 300 million. “Cottage Industry” covers household-based industrial units operated mainly with family labor.

According to the National Industrial Policy 2005 enterprises shall be categorized using the following definition (fixed investment implies exclusion of land and building, and valuation on the basis of current replacement cost only):

◆ **Small enterprise:** an enterprise should be treated as small if, in today’s market prices, the replacement cost of plant, machinery and other parts/components, fixtures, support utility, and associated technical services by way of capitalized costs (of turn-key consultancy services, for example), etc, excluding land and building, were to be up to BTD.15 million.

◆ **Medium enterprise:** an enterprise would be treated as medium if, in today’s market prices, the replacement cost of plant, machinery, and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and building, were to be up to BTD.100 million.

For **non-manufacturing** activities (such as trading or other services) we define,

- ◆ **Small enterprise:** an enterprise should be treated as small if it has less than 25 workers, in full-time equivalents.
- ◆ **Medium enterprise:** an enterprise would be treated as medium if it has between 25 and 100 employees [12].

Area of SMEs in Bangladesh:

There are nearly 1.5 million SMEs in Bangladesh, 60%–65% of which are located outside the metropolitan areas of Dhaka and Chittagong. There is a very high density of SMEs in the industrial economy of Bangladesh [2]. Generally Bakery, Specialized handlooms, Dyeing and printing, Footwear, Plastic products, Steel furniture, Electrical goods and electronics, Engineering workshops, Artificial jewelry, Wooden and steel furniture, Television and radio assembling, Soaps, Detergents, Food and allied products, Textiles and apparels, Engineering and fabricated metal products, Readymade garments, Printing and publishing, Wood and wood products etc. are covered the SMEs sector in Bangladesh. The explanation and development of SMEs sector has become most essential to the Government for sustainability of economical growth in Bangladesh. For this reason Government of Bangladesh has taken SMEs policy in 2005. The policy has suggested 11 booster sectors of SMEs in Bangladesh which will be get various types of facilities and opportunities from the Govt. and commercial Banks and other economical institutions [12]. These are I. Electronics and Electrical II. Software Development III. Light Engineering IV. Agro-processing and related business V. Leather and Leather goods Knitwear and Ready Made Garments VII. Plastics and other synthetics VIII. Healthcare and Diagnostics IX. Educational Services X. Pharmaceuticals/ Cosmetics/ Toiletries XI. Fashion-rich personal effects, wear and consumption goods. SME sector also prefer e-Banking system. E-Banking refers to system that enable bank customers to access accounts and general information on bank products and services through a personal computer (pc) or other intelligent device [8]. Electronic banking (e-banking) reduces the transaction costs of banking for both SMEs and banks. The adoption of online banking channels by Bangladeshi SMEs has been rather slow

when compared with the large companies in Bangladesh or SMEs in other developed countries [18]. We refer readers [16] for more information about E-Banking.

SMEs in Bangladesh Economy:

Despite high dependence on agriculture, other sectors are growing significantly in Bangladesh. Over the years, share of agriculture in GDP is declining with services being the drivers of growth. Manufacturing sector in Bangladesh has been contributing at a consistent rate over the last decade to around 15 percent [15]. SMEs in manufacturing and services combined have 19 percent share of GDP. A nationwide survey claims that Micro, Small and Medium Enterprises (MSMEs) value addition accounts for 20 to 25 percent of Bangladesh's GDP. These enterprises are accommodating more than 30 million people aged 15 years and above [3]. Therefore, SME sector deserves more attention and focus to foster growth and generate employment. However, the greatest potential of employment creation is among the SMEs involved in manufacturing. SMEs in manufacturing are important for the developed countries as well since growth of SME in manufacturing sector creates disproportionate amount of net employment because of its labor intensive character. However, SME in Bangladesh is dominated by trading. The key reasons for SMEs not entering the manufacturing sector in a major way are financial constraints, dismal state of utilities and government policy discriminations [13]. However, the role of SME in employment generation and poverty reduction has been well recognized in the PRSP (GOB, 2002).

Employment status of SMEs in Bangladesh:

SMEs create a large employ opportunity which is playing a vital role for both poverty alleviations and sustainable development of Bangladesh. In 1981 the number of small institutions was 24590 all over the country. After 10 years means in 1991 these number has been changed into 38294 and in 2001 (end of June) these number has become in 55916. The annual average growth rate is 6.36 percent. At the same time the employment status of the small enterprises were 322110 in 1981, 523472 in 1991 and 808959 in 2001. As a result the average employees' growth rate is 7.55 percent [5]. According to the South Asia Enterprise Development Facility (SEDF)

2003 reference the various categories of SMEs are reported to contribute between 80 to 85 percent of industrial employment and 23 percent of total civilian employment [4].

Table 1 The partial Employment growth rate of SMEs sector (Excluding Handlooms).

Year	Number of Small units	Employment
1981	24590	322110
1991	38294	523472
2001	55916	808959
Average annual growth rate	6.40 %	7.60 %

Source: Adapted from [5]

Table 1 shows that the number of small institutions and their employment status have been changed from 1981 to 2001 which average annual growth rate are respectively 6.40 percent and 7.60 percent. It is cleared that the changes position both small institutions and their employment status are so significant for sustainable development.

Value added contributions of SMEs in Bangladesh:

The correct magnitude, the SMEs are undoubtedly quite predominant in the industrial structure of Bangladesh comprising over 90% of all industrial units. This numerical prevalence of the SMEs in Bangladesh's industrial sector becomes visible in all available sources of statistics on them [5]. Through the value added contributions of SMEs in manufacturing, we find out the actual participations of SMEs in Bangladesh. According the sources (ADB, World Bank, Planning Commission and BIDS) relating to value added contributions of the SMEs is seen to vary between 45 to 50 per cent of the total manufacturing value added [4].

Table 2 Value Added contributions of SMEs in Industrial sector constant 1995/96 Prices by Size Category.

Year	Value Added in Large Industry (Million Tk.)	Value Added in Small Industry (Million Tk)	Share of Large Industry in Manfg. GDP	Yearly Compound Rate of Growth (%)	
				Large Industry	Small Industry
1995/96	175732	70619	71.3	5.7	8.3
1996/97	182704	76091	70.6	4.8	8.0
1997/98	199668	81240	71.1	6.3	7.6
1998/99	208033	81849	71.8	5.8	5.8
1999/00	217083	85122	71.8	5.8	5.5
Annual Average from 1995/96 to 1999/00	196644	71884	71.3	5.5	5.5

Source: Adapted from [5]

Above the table shows the value added contributions of small industries has been increased year by year. In this table in 1996/97 the value added contribution of small industries is BDT 76091 million which have become BDT 85122 million in 1999/00. As a result the annual average growth rate becomes in small industries at 5.5. These are more significant for poverty alleviation and sustainable development in Bangladesh.

Financing of SMEs in Bangladesh:

The total market size for loans to SMEs is estimated to be nearly BDT 400 billion (\$5.7 billion). The total amount of SME loans increased by BDT 100.2 billion (\$1.4 billion), or 40 percent to BDT 350.4 billion (\$5 billion) at the end of June 2008, in comparison to BDT 250.2 billion (\$3.6 billion) at the end of June 2007. In terms of institutional categories, loans extended to SMEs increased from June 2007 to June 2008 among private banks (+53.5 percent), non bank financial institutions (+43.4 percent), state-owned banks (+32 percent) and specialized banks (+15.1 percent). However, SME loans extended by foreign banks decreased by 20.5 percent [11]. Banks are the largest source of funding for SMEs. BRAC Bank and the state-owned BASIC Bank are the key players in SME finance in the country. SEDF has also facilitated the access of SMEs to formal financial services. The total SME loan portfolio reached BDT 350.4 billion (\$5 billion) in June 2008 (provisional),

Table 3 SME Loan Portfolios, 2007–2008

Name of Institutions	June 2008 (provisional)		December 2007	
	SME loans (BDT billions)	SME loans (% of total loan portfolio)	SME loans (BDT billions)	SME loans (% of total loan portfolio)
Private banks	198.90	19.7%	16,248.61	18.2%

State-owned banks	99.19	33.3%	9,577.60	22.7%
Specialized banks	32.50	22.9%	3,054.38	23.3%
Foreign banks	6.12	6.5%	427.00	5.1%
Nonbank financial institutions	13.68	19.7%	1,279.37	18.7%

Source: Meeting with Bangladesh Bank, Agricultural and Special Programs Department, summer 2008.

Above the table shows that SMEs loan has increased all types of commercial banks and other economical institutes at the end of June 2008, in comparison at the end of December 2007. This progressive (see Table 3) figure play a significant role for sustainable development in our country.

The leading financing Bank in SMEs in Bangladesh:

Fourteen private banks and twenty first financial institutes have gotten SME refinancing facilities from the Bangladesh Bank [11]. So, they are contributing SMEs sector in many ways. But the five Banks (BRAC Bank, Islami Bank, Eastern Bank Limited, Dhaka Bank limited, Prime Bank limited) are leading SMEs financing. As of June 2009, five banks are estimated to have 85% of the market share for SME lending nationwide, which equals a total of Tk75.5 billion. The remaining banks and financial institutions in Bangladesh hold an estimated 15% market share for SME lending. This suggests an estimated total current supply of SME credit (SME loan principal outstanding) of Tk. 88.8 billion [1].

Table 4 Estimated Credit Market for Bangladesh's SMEs

Different Banks in Bangladesh	Principal Outstanding (BDT in billion)
BRAC Bank	33.0
ISLAMI Bank	33.0
Eastern Bank Limited	3.5
Dhaka Bank Limited	3.0
Prime Bank Limited	3.0
Total SME Lending Volume (Principal Outstanding)	75.5
Estimated Market Share of Above Five Banks (%)	85.0
Total Estimated SME Credit Supply	88.8

Source: Asian Development Bank Estimates

Table 4 shows that the principal outstanding of BRAC Bank is BDT 33 billion, Islamic Bank is also BDT 33 billion and rest of the three Banks aggregate outstanding are BDT (3.5+3+3) 9.5 billion. BRAC Banks manage its SMEs activities with 469 units all over the country [15]. This a significant sight for developing of SME sector in Bangladesh. Islami Bank is also contributing both financing and creating employment. See [7] for more information about Islamic banking system in Bangladesh.

ACKNOWLEDGEMENT:

I am grateful to the authors of the references who have helped us indirectly through their immortal books, journals. I would like to thank Prof M H A Biswas, Mathematics Discipline, Khulna University, Bangladesh and editorial member of the journal Academic Research Int. for his valuable suggestions and comments which help me to improve this paper. I would also like to thank my supervisor Dr. K Uddin of Kustia University, Bangladesh for his guidance while preparing this article.

CONCLUSION:

The small and medium-sized enterprise (SME) sector is critical for output growth and employment creation since SMEs account for (i) 99% of private sector industrial establishments in Bangladesh, (ii) about 25% of gross domestic product (GDP), and (iii) more than 75% of employment in the private sector in Bangladesh [10]. Nevertheless, SMEs are not realizing their full potential for contributing to Bangladesh's economic growth and employment. Strong SME growth could therefore emphasize Bangladesh's drive to achieve prosperity and increase employment. This sector is not coming stronger. A close scrutiny and careful interpretation tends to reveal that lack of institutional credit, non-availability of working capital, low levels of technology, low productivity, and lack of marketing facilities and market access problems are the major bottlenecks to SME growth in Bangladesh. In the recent years, domestic law and order conditions, unreliable power supply and stiff competition both in domestic and international markets seem to have been the added dimensions to the SME operational bottlenecks. However, for systematic and in-depth studies on SMEs and for the sustainable development by SMEs in Bangladesh we propose the following recommendations:

1. A clear-cut commitment for SMEs from the Government.
2. Government should ensure political stability in the country.
3. Efficient and sustainable developments of infrastructures and communications in the country.

4. The monitoring systems of financing institutions on SMEs should be under intensive investigations.
5. Above all, anti-corruption activities should be increased for a fruitful result from SMEs sectors.

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