



**Business Finance for the  
Poor in Bangladesh**

# **POLICY STUDY CATALYSING BUSINESS UPSCALING**

**A study on Cluster and Value Chain Financing  
for MSEs in Bangladesh:  
Current Status and Way Forward**

Executing Agency



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## Acronym

ADB	Asian Development Bank
BB	Bangladesh Bank
BLRSMA	Bangladesh Leather and Rixin Shoe Manufacturer's Association
BPBA	Bangladesh Plastic Business Association
BEMMA	Bangladesh Electrical Merchandise Manufacturer's Association
BEIOA	Bangladesh Engineering Industries Owner's Association
BIBM	Bangladesh Institute for Bank Management
BFP-B	Business Finance for the Poor in Bangladesh
BFID	Bank and Financial Institution Division
BSCIC	Bangladesh Small and Cottage Industries Corporation
FGD	Focus Group Discussion
FEDEC	Finance for Enterprise Development and Employment Creation
IDI	In-depth Interview
IFAD	International Fund for Agricultural Development
ILO	International Labour Organization
JICA	Japan International Cooperation Agency
KII	Key Informants Interview
GoB	Government of Bangladesh
LAN	Local Area Network
MRA	Microcredit Regulatory Authority
MEDA	Mennonite Economic Development Associates
M&E	Monitoring and Evaluation
MFI	Microfinance Institutes
MoF	Ministry of Finance
MSE	Micro and Small enterprises
NASCIB	National Association of Small and Cottage Industries of Bangladesh
NBFI	Non-Banking Financial Institutes
NGO	Non-Government Organisation
PAC	Policy Advisory Committee
PKSF	Palli Karma-Sahayak Foundation
PRIME	Programmed Initiative for Monga Eradication
PROSPER	Promoting Financial Services for Poverty Eradication
PO	Partner Organization
SME	Small and Medium Enterprises
SPV	Special Purpose Vehicle
TOR	Terms of Reference
UNCDF	United Nation's Capital Development Fund

## Executive Summary

The UKAid funded Business Finance for the Poor in Bangladesh (BFPB) project commissioned this study with the objectives to define interventions that are required to address the challenges for cluster and value chain development and financing and define the role of different actors (BB, MRA, SME foundation, BSCIC, PKSf etc.) and to provide policy recommendations to BB, MRA and other policy makers to develop a more effective policy environment to promote cluster and value chain development and financing in the short, medium and long terms. Set on these objectives, this report presents the findings from the quantitative and qualitative investigation undertaken on the demand side, the supply side, the support functions and the rules and regulations pertaining to the MSME financing market systems in Bangladesh.

The consultants applied quantitative and qualitative research methods to undertake the study. The respondents include actors from the demand side, supply side, support service providers and the regulatory environment. On the demand side, we collected qualitative information from 282 value chain actors who participated in 28 FGDs in 30 clusters in 10 sectors. Furthermore, we undertook 22 In-

depth Interviews with female entrepreneurs. Quantitative data was collected from 1,734 MSMEs in 60 clusters in 10 selected sectors across Bangladesh. This included 594 manufacturers/producers, 446 raw material providers, 458 support service providers and 236 traders. The respondents on the supply side include representatives from 25 financial institutions and 20 informal financial service providers. Respondents also include representatives from 10 support service providers and 7 government and non-governmental organizations working on financial inclusion of the MSMEs in Bangladesh. Annex 1 provides a detailed account of the methodology applied for this study.

The findings show that MSMEs in the clusters and the value chains are heterogeneous business enterprises with diversified business and financing needs and financial practices. 70% of the MSMEs in the clusters are micro-enterprises. In the value chain related to the product being produced in the clusters, about 94% of the enterprises belong to the micro enterprise category. Extending the definition of clusters to incorporate the backward and forward market linkage actors, the portfolio for

MSME financing would allow for more diversified range of financial services. The loan size varies between the MSMEs as per their business registration, business premise and ownership of the business premise. Differentiated are essential since the MSMEs are not at the same level playing ground. Sectoral differences need to be accounted for in this context. The financing need of the MSMEs vary. 90% of the manufacturing enterprises in the clusters want finance to invest on working capital; 36% want finance to invest on new machineries and 30% want to invest on increasing stock. Amongst the enterprises in the backward and forward market linkage 86% want finance for working capital; 16% for capital machineries and 34% for stocking. Term loans are more suitable for stocking than overdraft. Lease financing is suitable for capital machineries while time loan or demand loan is suitable for working capital. However, most of the MSMEs are sole-proprietorship and thus banks are reluctant to provide term loans without mortgage which most of the enterprises are not able to provide. Besides, for time loan, it is essential that the MSME cash cycle is predictable. Most of the MSMEs do not have control on their cash cycle. MSMEs also often do not have formal contracts or work orders. To mitigate these challenges hybrid financing models that combine term loans and overdrafts could be more suitable for working capital finance and stock finance.

The findings show that there are larger number of MSMEs who have never secured external finance for their business. Furthermore, almost half of the enterprises do not have active loans with formal institutions. We can construct two possible scenarios based on this- (i) the MSMEs do not need external finance or (ii) MSMEs are not able to secure finance from formal sources and are therefore dependent on other sources. 34.7% of the surveyed enterprises never secured any external financing. The incidence is higher amongst the micro enterprises in comparison to small enterprises. Of those who never secured external financing, 71% are micro enterprises. Findings further show that almost half of the manufacturing enterprises and the enterprises in the forward and backward market chain do not have active loans. The key reasons for the micro enterprises for not securing external finance are (i) lack of bank transaction history (20.5%); lack of collateral (16.7%) and lack of financial knowledge (17.9%). Large number of micro enterprises reported that they do not need external finance (24.4%). The key reasons for the small enterprises for not

securing external finance is high rate of interest (45.5%) which is followed by lack of collateral (18.2%). About 27.3% of the small enterprises reported that they do not need loan for their business. Based on the findings from the FGDs we can attribute the lack of demand for financing to the fact that large number of enterprises prefer to do business on cash and therefore prefer to have shorter business cycles.

MSMEs in the clusters meet their financing needs through diverse sources. This includes the formal financing sources (banks, NBFIs, MFIs) and informal sources (friends and family members, mohazons, relatives). We can observe variance amongst the micro enterprises and the small enterprises with respect to their sources of finance. Micro enterprises are more reliant on MFIs while small enterprises are more reliant on Banks. Micro enterprises also have higher incidence of securing finance from family and friends, cooperatives and suppliers. Use of bank accounts for business transaction is still not universal. 62% of the respondent MSMEs have company bank accounts. On the flipside, 68% of the MSMEs who reported of not using bank accounts reported that they prefer to transact through cash. 37% of the MSMEs in the clusters have mobile banking account. 51% of the respondents who do not use mobile banking for business transaction identified the inability to make high value transaction as the key barrier. This possibly indicates that the MSMEs are not aware of merchant bank account for business transactions.

Assessment of the financial literacy of the MSMEs in the clusters and in the value chains show that the MSMEs are aware of the interest rates for the loans, the loan tenure and the type of loan that they are availing. However, the MSMEs across the value chain lack knowledge on grace period, security requirements.

We can observe high variance between the male led enterprises and female led enterprises with respect to their financing needs and practices. 93.5% of the respondent female enterprises belong to the micro-enterprise category. The female led enterprises have significantly lower fixed assets (BDT 612,980) if compared to male led enterprises (BDT 13,82,005). 98.7% of the female led enterprises are sole proprietorship. In contrast 87.8% of the male led enterprises are sole proprietorship. 92.2% of the female led enterprises operate from home. In contrast, 34.8% of the male led enterprises operate from home. 76.6% of the

female led enterprises do not have trade license while 27.4% of the male led enterprises do not have trade license. 72.7% of the female led enterprises do not have membership with any trade association. 50.6% of the male led enterprises do not have membership with trade associations. Female led enterprises are more dependent on MFIs and friends and family for financing. 42% of the female led enterprises secure finance from MFIs; 21.1% secure finance from friends and family; 23.7% secure finance from Banks. Women entrepreneurs are mostly concentrated in small low value added clusters where they work primarily as wage earners. The capacity of the women entrepreneurs to scale up their business operations through cluster or value chain financing is low in this context.

Finance is a challenge but not the only challenge that restrict the MSME's growth. Non-financial barriers limit MSMEs capability to access finance. Our findings show that finance is one of the barriers that restrict the MSMEs to grow their businesses. There are other non-financial barriers that limit their growth prospect. This includes high cost of the raw materials, unskilled manpower, high cost of machineries, high competition in the market, lack of space for business expansion and declining demand. The scope for cluster and value chain financing in this regard should be seen not only from the perspective of finance but on the perspective of the scope for using these two financial instruments to tackle the MSME barriers to growth.

We used the quantitative data and qualitative information collected from the field to grade the clusters that were selected for the purpose of the study. The review suggests that the immediate prospect for cluster and value chain financing exist in the salt manufacturing, rice husking mills and health care and diagnostics clusters. The regular financial instruments (term loans, CC loans etc.) could be promoted in these clusters in addition to factoring, warehouse receipt and such.

The opportunity for cluster and value chain financing is also immediate in the electrical and electronics, embroidery, knitwear, RMG wholesale, Jamdani, Benarasi and Katan, Agor Ator and Light Engineering and Metal works clusters. But these clusters would require public and private sector intervention to develop common facilities, common infrastructure and alternative financing instruments (For instance Special Purpose Vehicles) to make the enterprises grow.

The prospect for value chain and cluster financing is not immediate in the plastics and other synthetics, leather making and leather goods and handloom clusters. The enterprises in these clusters face significant non financial barriers that need to be addressed. For instance, investment in the leather and leather shoe making cluster is currently limited due to uncertainty resulting from planned relocations. We categorized these clusters as incubate.

The prospect for cluster and value chain financing is not immediate and relevant to several clusters. This includes fish processing cluster in Rupsha (Khulna), Bamboo and Cane Cluster (in Jessore), Wooden Furniture (in Pirojpur), Jewelry Cluster (in Mymensingh) and the Cotton thread cluster (in Comilla). These clusters face varying degree of challenges that cannot be solved through cluster and value chain financing. For instance, the women crafts producers (basketry) in Jessore are engaged in production of hand made export oriented baskets. The demand for the product is low and the ability of the enterprises to expand their business is limited since the business is dependent on their own manual labor. In the shrimp cluster, the government's special subsidy programmes already exist to facilitate finance for the enterprises. We categorized these clusters as observe.

Large number of MSMEs are dependent on informal sources to meet their business needs. Large number of MSMEs remain outside the domain of formal financial services. Extrapolation of our field data shows that the MSMEs in the clusters in the 10 selected sectors have secured finance worth BDT 17,553 crores from the formal financial institutions. In contrast they have secured finance worth BDT 39,589 crores from informal financial institutions. Our findings show that there is a prospective market for factoring worth BDT 3961 crores. The prospective market size for working capital financing is worth TK 8178 crores. The prospective market size for warehouse receipt is BDT 4995 crores while the prospective market for machineries financing is BDT 9408 crores.

Based on the findings from the field interviews with the stakeholders we can ascertain that MSME financing is a key agenda for the formal financial institutions. However, their capacity to serve the MSMEs vary. State owned banks are operating within the purview of the BB policy. They are preferred by MSMEs operating in the export market. These banks are unlikely to

invest on developing the MSME capacity for financial readiness if not directed, mandated and capacitated by the central bank. Private commercial banks are being increasingly competitive with expanding network and diversified products. The competition could drive them further to invest on building MSME capacity for financial readiness. However, they would require state support to sustain the investment. NBFIs are more suitable for certain type of products and clusters (for instance those requiring capital machineries). However, they have limited national outreach. They are more likely to deepen their engagement with clusters that they are currently serving. Foreign commercial banks are unlikely to invest on capacity development of the micro enterprises given the cost of business and their global strategy for risk mitigation. They are more likely to deepen their engagement through MFIs. MFIs are more suitable for MSME development through cluster and value chain based financing approach. But they are yet to take up national level intervention for investment on collective development needs. Focus remains individual enterprises.

For the MSMEs to grow, they need to be able to use the financial instruments to support their competitiveness. Our study shows that the majority of MSMEs are using financial services. But these are not essentially contributing to their growth/ competitiveness as the available instruments are not tailored to solve the MSME financial needs and challenges. Our study suggest that the existing policy is supply driven whereby the performance is measured by outreach and value of total lending. The policies are thus designed to ensure that the government's financial stimulus are reaching out to wider number of sectors and clusters at the cost of deeper impact per enterprise per

cluster. The existing policies neither capacitate nor dictate financial institutions to be proactive. The institutions are mostly taking reactionary measures for cluster and value chain financing. As such the promise remains unexplored. To mitigate the systemic challenges, we recommend the following road map that needs to be facilitated through relevant changes/ amendment to the national MSME development policy.

- Define the central agency for coordination and management of MSME development in Bangladesh.
- Define the roles of individual agencies engaged in MSME development
- Have a central definition of the scope and the development agenda to which all agencies should subscribe to
- Define cluster and value chain finance from the perspective of development finance and investment
- Channel incentive schemes towards development need of the cluster and value chains rather than individual MSME financing needs
- Support establishment of private sector cluster development and consultation agencies
- Pilot the concepts of special purpose vehicle (SPV) for cluster financing
- Establish incentive financing schemes for value chain financing instruments like warehouse receipt and factoring
- Build capacity of the trade associations to provide financial counseling and advisory services to the MSMEs
- Establish one stop trade centers for women entrepreneurs

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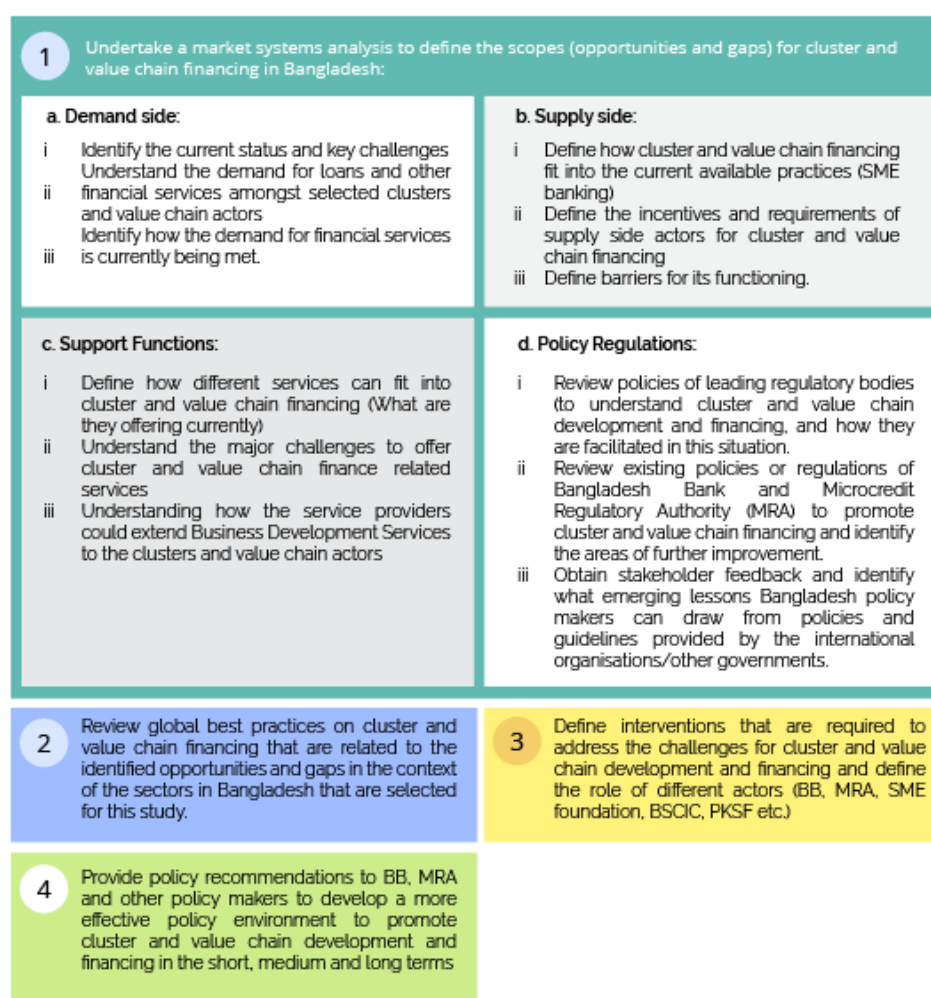
# 1: Introduction

## 1.1 Background

The UKAid funded Business Finance for the Poor in Bangladesh (BFPB) project commissioned this study with the objectives to define interventions that are required to address the challenges for cluster and value chain development and financing and define the role of different actors (BB, MRA, SME foundation, BSCIC, PKSf etc.) and to provide policy recommendations to BB, MRA and other policy makers to develop a more effective policy environment to promote cluster and value chain development and financing in the short,

medium and long terms. Set on these objectives, this report presents the findings from the quantitative and qualitative investigation undertaken on the demand side, the supply side, the support functions and the rules and regulations pertaining to the MSME financing market systems in Bangladesh.

**Figure 1: Synopsis of the Study Objectives**



## 1.2 Context of the Study

This study builds on three underlying issues: (i) the economic significance of MSMEs in Bangladesh (ii) the financial inclusion barriers faced by the MSMEs in Bangladesh and (iii) growing interest among national stakeholders in adopting cluster based approach for financing for MSMEs. Figure 1 provides a synopsis of the objectives of the study.

**The economic significance of MSMEs in Bangladesh:** MSMEs constitute 91% of all enterprises in Bangladesh. This shows the significance of the MSME sector in the overall private sector in Bangladesh<sup>1</sup>. Within the MSME sector in Bangladesh, micro enterprises dominate if we account for the total number of enterprises. Around 40.6% of the MSMEs in Bangladesh are categorized as micro, 36.6% as small and the rest 14.3% are medium enterprises if we consider number of establishment as a way to measuring. However, if we account for gross value added the MSME sector contribution comes down to 52.9%. The share of micro, small and medium enterprises also change with small enterprises (23.7%) marginally leading the share in comparison to the medium enterprises (23.3%). The share of micro enterprises (5.9%) is very low if considered in relation to small and medium enterprises<sup>5</sup>. Overall 41% (approximately 2 million) of the total workforce in Bangladesh (5 million) is engaged with MSMEs. Women-owned enterprises are only 7.21% of the total number of enterprises, and labor force participation rates are 29% for women and 86% for men<sup>2</sup>. According to BWCCI (2010), among the women enterprises, 69.4% enterprises are in the handicraft sector and 16.1% are in readymade garments and home textile sector.

**The financial inclusion barriers faced by MSMEs in Bangladesh:** Ninety percent of all

MSMEs in Bangladesh have ten or fewer workers. Access to finance remains one of the key constraints for 68.6% of microenterprises with 10 to 24 workers. In Bangladesh, 26.5% of small firms and 22.7% of medium firms consider access to finance a major constraint. The medium and large enterprises have more access to bank credit, while micro and small enterprises (MSEs) utilise microcredit. The financial challenges for women-owned enterprises are even greater than for men due to a range of systemic barriers in Bangladesh as elsewhere in internationally.<sup>3</sup>

**Growing interest among national stakeholders in adopting cluster based approach for financing for MSMEs:** Bangladesh Bank (BB) launched the SME and Special Programmes Department (SME&SPD) in 2009 to facilitate MSME financing. Subsequently, the SME Credit Policy and Programmes was launched in 2010. It identified cluster development as a key policy agenda for MSME financing. As per the 'SME Credit Policy and Programme' document, banks and non-bank financial institutions are expected to extend area and cluster based loan disbursement by diversifying the lending through SME clusters. In 2010, BB also introduced target based SME<sup>4</sup> lending. In this innovative approach, the financial institutions are allowed to independently set their targets. With the exception of 2011, the targets have always been exceeded. Besides, the target for SME lending increased from BDT 388.58 billion in 2010 to BDT 1338.53 billions in 2017; this shows the positive growth in SME lending in Bangladesh. Complementing the BB efforts, the Small and Medium Enterprise Foundation (SMEF) has undertaken a comprehensive study on MSME clusters in Bangladesh. It identified 177 clusters in 11 selected subsectors across the country. SMEF runs a Credit Wholesale Programme (CWP) through Banks and NBFIs with the aim to channel collateral free single digit rate of interest loans (maximum 9%) to MSMEs in targeted clusters. The programme is overseen by a working

<sup>1</sup> Bangladesh Bureau of Statistics (BBS) Economic Census 2013

<sup>2</sup> Bangladesh Bureau of Statistics (BBS) 2005

<sup>3</sup> Chowdury, J.A. *Microcredit, micro-enterprises, and self-employment of women: experience from the Grameen Bank in Bangladesh*. FAO 2009. [http://www.fao-ilo.org/fileadmin/user\\_upload/fao\\_ilo/pdf/Papers/18\\_March/Chowdhury-final\\_pdf.pdf](http://www.fao-ilo.org/fileadmin/user_upload/fao_ilo/pdf/Papers/18_March/Chowdhury-final_pdf.pdf)

<sup>4</sup> The scope of this study extends to micro, small and medium enterprises (MSMEs). However, much of the key documents in Bangladesh consider Small and Medium Enterprises or SMEs instead of MSMEs. We have used the original terms of the documents and therefore both terms appear in various sections of this report.

committee that represents the key institutions-BB, PKSF (the micro-credit wholesale agency in Bangladesh), SMEF and representatives from commercial banks. As of June 2017, the

programme had BDT 59.97 crores of loans disbursed in 17 clusters through 12 financial institutions.

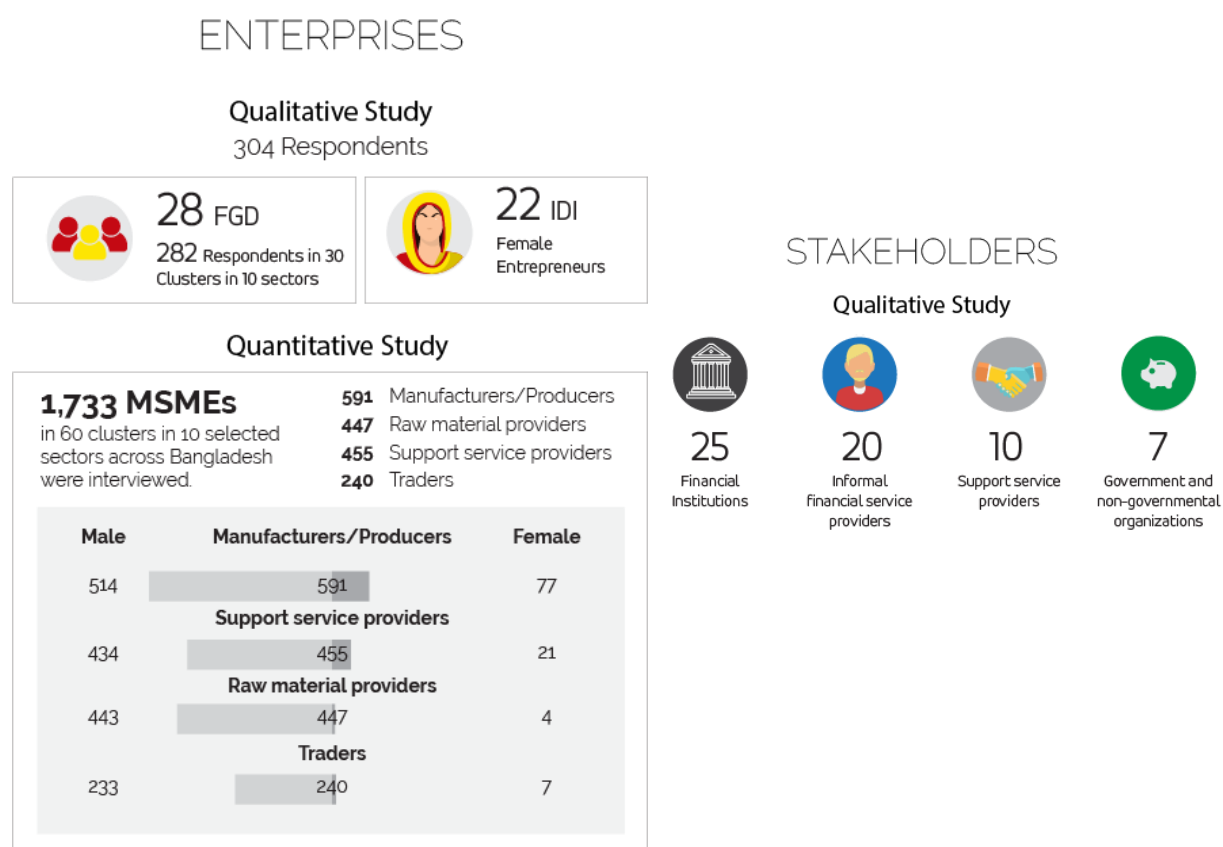
## 1.2 Methodology

The consultants applied quantitative and qualitative research methods to undertake the study. The respondents include actors from the demand side, supply side, support service providers and the regulatory environment.

On the demand side, we collected qualitative information from 282 value chain actors who participated in 28 FGDs in 30 clusters in 10 sectors. Furthermore, we undertook 22 In-depth Interviews with female entrepreneurs. Quantitative data was collected from 1,734 MSMEs in 60 clusters in 10 selected sectors

across Bangladesh. This included 594 manufacturers/producers, 446 raw material providers, 458 support service providers and 236 traders. The respondents on the supply side include representatives from 25 financial institutions and 20 informal financial service providers. Respondents also include representatives from 10 support service providers and 7 government and non-governmental organizations working on financial inclusion of the MSMEs in Bangladesh. Annex 1 provides a detailed account of the methodology applied for this study. Figure 2 provides a synopsis of the study methodology.

**Figure 2: Synopsis of the Study Methodology**





**25**  
Financial Institutions



**20**  
Informal financial service providers



**10**  
Support service providers



**7**  
Government and non-governmental organizations

## 1.3 Key Concepts and Theoretical Framework Used in the Study

This study builds on the concepts and definitions of MSMEs, clusters, value chains, cluster financing and value chain financing and their relevance to MSME competitiveness. This study also builds on the concepts of market

systems and systemic change as per the markets for poor or M4P approach. It is recommended that the readers review this section since the findings are presented in line with the discussion in this section.

### 1.3.1 Micro, Small and Medium Enterprises (as per Industrial Policy 2016)

The Ministry of Industries (Mol) Government of Bangladesh (GoB) has restructured and redefined the different categories of industries and enterprises in Bangladesh in the Industrial Policy 2016 which is amendment to the

Industrial Policy 2010. The policy defines enterprises into various categories- large, medium, small, micro, cottage based, handicrafts, high-tech industries, creative industries, reserved industries, high priority industries, priority industries and controlled industries.

#### Micro Enterprises

Manufacturing industries that have, without accounting for the value of land and factory building, fixed assets with replacement cost worth TK 1 million to TK 7 million or industries where 16-30 or lesser number of workers are employed.

Service industries that have, without accounting for the value of land and factory building, fixed assets with replacement cost worth TK 1 million or less or industries that employ less than 15 workers

#### Medium Enterprises

Manufacturing industries that have, without accounting for the value of land and factory building, fixed assets with replacement cost worth TK 150 million to TK 500 million or industries which employ 121-300 workers.

Service industries that have, without accounting for the value of land and factory building, fixed assets with replacement cost worth TK 20 million to TK 300 million or industries that employ 51-120 workers. \

#### Small Enterprises

Manufacturing industries that have, without accounting for the value of land and factory building, fixed assets with replacement cost worth TK 7.5 million to TK 150 million or industries which employ 31-120 workers.

Service industries that have, without accounting for the value of land and factory building, fixed assets with replacement cost worth TK 1 million to TK 20 million or industries that employ 16-50 workers.

### 1.3.2 Clusters

The United Nations Industrial Development Organization (UNIDO) defines cluster as “sectoral and geographical concentration of enterprises and/or individual producers that produce a similar range of goods or services and face similar threats and opportunities. A cluster encompasses enterprises (MSMEs, but also larger firms) as well as their support institutions from the public and private sectors as well as civil society.”<sup>5</sup> UNIDO defines these enterprises and/or individual producers in the cluster as principal firms. UNIDO also takes into account the firms of backward and forward linkages and service providers, including different technical, academic and financial institutions, business associations, and local authorities as a part of that cluster. However, the location of these firms can be spread out over villages, a town or a city and their surrounding areas<sup>8</sup>.

In Bangladesh SME foundation have defined clusters as enterprises that

### 1.3.3 Value Chains

There are many definitions for value chains and approaches to value chain development – too much in fact to iterate here. Rather, we draw on the earliest and most widely used definitions, and then discuss how these correlate with the definition of clusters described above.

Porter’s<sup>7</sup> value chain definition is one of the earliest definitions of value chain which divided the market activities into primary activities which include inbound logistics, operations, outbound logistics, marketing, sales and service and secondary activities which include procurement, human resource management, technological development, and infrastructure. Businesses utilize the primary and secondary activities as “building blocks” to develop their product or service.

must be production or service units, including forward and backward linked industries, numbering 50 units or more, and within an adjoining geographical locations (several villages, wards, unions and industrial estates) scattered within an area of 5 kilometre radius<sup>6</sup>. The clusters are known by the product/service, which is manufactured/ processed/ served in that geographical area. Raw materials suppliers, machinery suppliers, traders, wholesalers, retailers, exporters, importers etc. are the forward and backward market actors. Firms also take services such as relevant training, information, and financial help etc. from several types of service institutes.

In our study we used the SMEF definition of clusters to identify the clusters for our assessment. However, we used the UNIDO definition of clusters to assess the competitiveness of the clusters in Bangladesh and to recommend the future course of action with respect to financing these clusters to improve their competitiveness.

USAID defines value chain as “The value-creating flow of a good from raw materials, production, commercialization, and ultimately delivery to end-users or consumers”.<sup>8</sup> Value Chain (Agriculture VC) is most commonly defined as the flow of inputs to and among the various links or actors (such as businesses starting from farming up to processing, wholesale and export) within a one particulate commodity. In our study we used the USAID definition of value chains to assess the competitiveness of the value chains within a cluster.

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<sup>5</sup> The Unido Approach to Cluster Development, Key Principles and Project Experiences for Inclusive Growth, 2013

<sup>6</sup> SME foundation (2013), SME clusters in Bangladesh, Small and Medium Enterprises, March 2013.

<sup>7</sup> Porter, Michael E., “Competitive Advantage”. 1985, Ch. 1, pp 11-15. The Free Press. New York.

<sup>8</sup> USAID 2008: Value Chain and Cluster Approach: Transformation relationships to increase competitiveness and focus on end markets

### 1.3.4 Distinctions between Clusters and Value Chains

A value chain may or may not be present within a specific cluster. However, if we use the definition of UNIDO for clusters, it can be observed that a competitive value chain is the one which has the relevant backward and forward market linkages and the support functions present within the cluster. Enterprises in a competitive value chain benefit from increased profits & sales and cost reductions, improved quality of the goods through the streamlined

operations and business relationships along the value chain; the value chain allows firms to focus on their core competences. On the other hand, clusters allow for information and knowledge sharing amongst the enterprises in the cluster. The enterprises in the cluster benefit from the economies of scale in the use of common infrastructure, cross cutting policies and cross cutting support services including finance. The enterprises in the clusters also benefit from external economies due to location and proximity.

Element	Clusters	Value Chains
<b>Definition</b>	Defined by geographic concentration of enterprises that are engaged in the production and marketing of a product or service	Defined by the flow of product among different interconnected enterprises which may or may not be concentrated within the same geographic location
<b>Relationship between the enterprises</b>	The relationship between the enterprises in the cluster is cooperative and competitive	The relationship between the actors in a value chain is sequential
<b>Benefits to the enterprises</b>	Enterprises in a competitive value chain benefit from increased profits & sales and cost reductions, improved quality of the goods through the streamlined operations and business relationships along the value chain; the value chain allows firms to focus on their core competences	Clusters allow for information and knowledge sharing amongst the enterprises in the cluster. The enterprises in the cluster benefit from the economies of scale in the use of common infrastructure, cross cutting policies and cross cutting support services including finance. The enterprises in the clusters also benefit from external economies due to location and proximity.

### 1.3.4 Cluster Financing

Cluster financing is not defined in the policy documents in Bangladesh. The Reserve Bank of India (RBI) defined cluster based approach to financing as “full service approach that is intended to cater to the diverse needs of the MSE sector which may be achieved through extending banking services to recognized MSE clusters.” Available literature suggests that cluster-based

lending is initiated to increase credit flow to MSMEs and reduce transaction costs for the banks or the financing institutions. Given this, it is expected that the financial institutions will offer borrowers favourable terms if the borrowers come together collectively. Furthermore, financial institutions are expected to consider MSMEs from a known cluster to be less risky compared to enterprises that are outside a cluster.

### 1.3.5 Value Chain Financing

Value chain finance refers to financial products and services that flow to or through any point in a value chain that enable investments that increase actors' returns and the growth and competitiveness of the chain<sup>9</sup>.

A critical component of value chain financing (VCF) is the flow of finance among the various value chain (VC) actors to address the needs and constraints of those involved in that chain, be it a need to access finance, secure sales, procure products, reduce risk or improve efficiency within the chain. However, VCF

Internal value chain finance mechanisms include product financing or credits. These credits most often assume the form of either: 1) pre-financed sales' when credit is provided to farmers by vendors who sell farm inputs, or 2) advance payments' given by buyers who purchase farm outputs. Various forms and instruments of product financing have been used for centuries and are often in-kind credit, such as in the form of seeds and fertilizer to the farmers. The product financing might also include different modified instruments such as trader credit, input supplier credit and lead firm financing.

External value chain finance incorporates third financing parties, usually financial institutions and can be broken down into two categories:<sup>11</sup>

- Receivables financing that might be the case when a bank or other financier advances working capital to agribusiness receivables (supplier, processor, marketing and export) companies against accounts finance receivable or confirmed orders to producers. Receivables financing considers the strength of the buyer's purchase and repayment history. Factoring, another type of receivable financing, is a financial transaction whereby a business sells its accounts receivable or contracts of sales of goods at a discount to a specialized agency, called a factor, who

includes both internal and external forms of finance:<sup>10</sup>

- Internal value chain finance is that which takes place within the value chain such as when an input supplier provides credit to a farmer, or when a major firm advances funds to a market intermediary;
- External value chain finance is that which is made possible by value chain relationships and mechanisms. For example, a bank issues a loan to farmers based on a contract with a trusted buyer or a warehouse receipt from a recognized storage facility

pays the business minus a factor discount and collects the receivables when due. Factoring speeds working capital turnover, credit risk protection, accounts receivable bookkeeping and bill collection services.

- Physical asset collateralization might include warehouse receipts where farmers or other value chain enterprises receive a receipt from a certified receipts warehouse that can be used as collateral to access a loan from third party financial institutions against the security of goods in an independently controlled warehouse. Such systems ensure quality of inventory, and enable sellers to retain outputs and have opportunity to sell for a higher price during the off-season or other later date. The most conventional form of the external value chain financing when using physical assets is when the financial institution provides financing directly to the value chain actors against the value of their marketable assets such as property, machinery and other assets.

In our study, we looked at cluster and value chain financing from the perspective of whether it contributes to the collective growth of the cluster and the value chain by mitigating the challenges across the cluster and the value chain. In other words, financing individual

<sup>9</sup> <https://www.microlinks.org/good-practice-center/value-chain-wiki/value-chain-finance>

<sup>10</sup> Miller C. and Jones, L. (2010) *Agriculture Value Chain Finance*. FAO, Rome / Practical Action Publishing, UK.

<sup>11</sup> Miller and Jones (2010) *Ibid*

enterprises within a cluster or a value chain is considered as traditional MSME financing but

not cluster or value chain financing which is more systemic.

## 1.4 Relevance of cluster and value chain financing to MSME competitiveness

In any competitive market, capacity and efficiency of individuals MSMEs might not be enough to strive the market. MSMEs will need to achieve economies of scale, internalise improved support functions, efficient allocation of resources and technology. Cluster and value chain financing in this context, help improve MSME competitiveness by driving finance towards enhancing the competitiveness of the MSMEs in the clusters and value chains. The following benefits in this context are noteworthy.

- Help to channel MSME financing to specific development needs of the MSMEs in the clusters and the value chains.

- Help to make the financial instruments demand driven, rather than supply driven.
- Help channel finance to MSMEs in clusters and value chains where finance can have positive impact on the growth and competitiveness of the MSMEs.
- This approach for financing could help financial institutions increase efficiency in marketing their services and improve their success ratio in securing clients.
- Help carb exploitation of low income manufacturing enterprises by the buyers and suppliers in the value chain.

## 1.5 MSME Financial Market Systems

The Springfield Centre (2016) defined a market system as “a multi-function, multi-player arrangement comprising the core function of exchange by which goods and services are delivered and the supporting functions and rules which are performed and shaped by a variety of market players.”<sup>12</sup> There are four key elements of a market system: the demand side, the supply side, the support functions and the rules governing the market. In light of this, we defined the MSME financial market systems in Bangladesh as below:

**Demand Side:** The demand side is related to This comprises all the MSMEs in the cluster and the value chain and the corresponding support services being provided to the value chain actors.

**Supply side:** The supply side comprises all formal and informal financial service providers serving the financial needs of the MSMEs. This includes national commercial banks, private commercial banks, non-bank financial institutions, Micro Finance Institutions, informal money lenders, friends and relatives of the MSMEs and any other source from which finance is being secured by the MSMEs.

**Support functions:** In this study, support functions refer to training, research, advisory and advocacy services, media and market promotion services, credit rating services, refinancing services and such that facilitate the demand for and supply of MSME financing.

**Rules:** This includes the formal policies and the informal rules and norms that govern the demand and supply of finance in the clusters and value chains. The national MSME development strategy, Industrial policy 2016, financial inclusion strategy, SME financing policy of Bangladesh Bank, SME development policy of SMEF and the policies of the development aid agencies, Bangladesh Government’s 7th Five Year Plan constitute the regulatory framework for MSME financing in Bangladesh. The socio economic norms of sourcing loans or grants, for instance preference to do shariah banking, or preference to do cash based transaction etc. also regulate the financing behavior of the MSMEs.

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<sup>12</sup> The Springfield Centre (2015) The Operational Guide for the Making Markets Work for the Poor (M4P) Approach, 2nd edition funded by SDC & DFID

<http://www.springfieldcentre.com/wp-content/uploads/2015/11/2015-09-M4P-Op-Guide-Sept2015.pdf>

## 2: The Market Landscape for Cluster and Value Chain Financing in Bangladesh

### 2.1 Distribution of micro, small and medium enterprises in the clusters and the value chains

There is a higher concentration of micro enterprises in the manufacturing function of the value chains. While micro-enterprises still dominate among the enterprises in the backward and forward market linkages of the value chains, there is considerably higher concentration of small and medium enterprises in the backward and forward market linkages in the value

chains. SMEF primarily defined the clusters based on the concentration of the manufacturing enterprises. It can thus be argued that the prospect for financing is higher if the overall value chain is considered rather than the clusters. This also signifies the importance of using the UNIDO definition of clustering which highlights the need to have forward and backward market linkage actors and the support service providers within the clusters.

**Figure 3: Concentration of micro, small and medium enterprises in the clusters as opposed to the value chain**

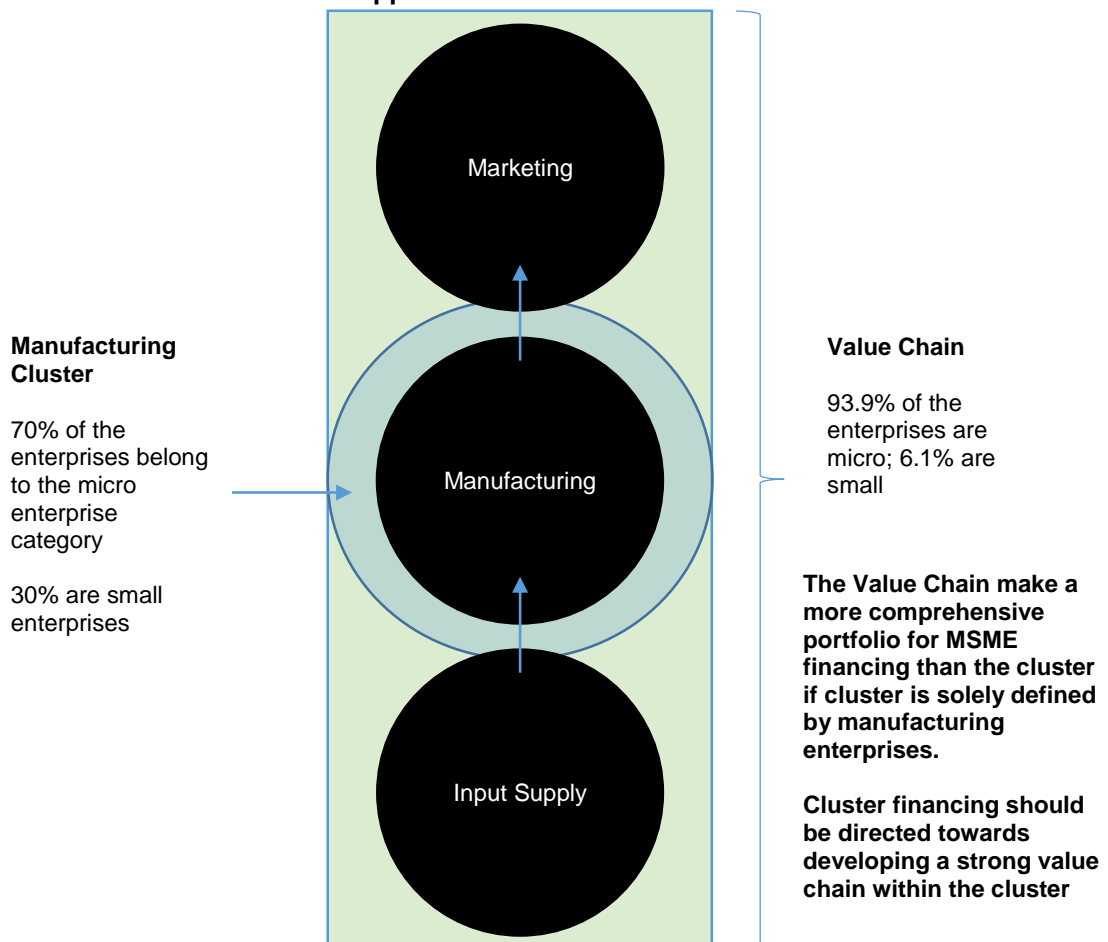


Figure 4: Sectorwise percentage distribution of micro and small enterprises in the clusters

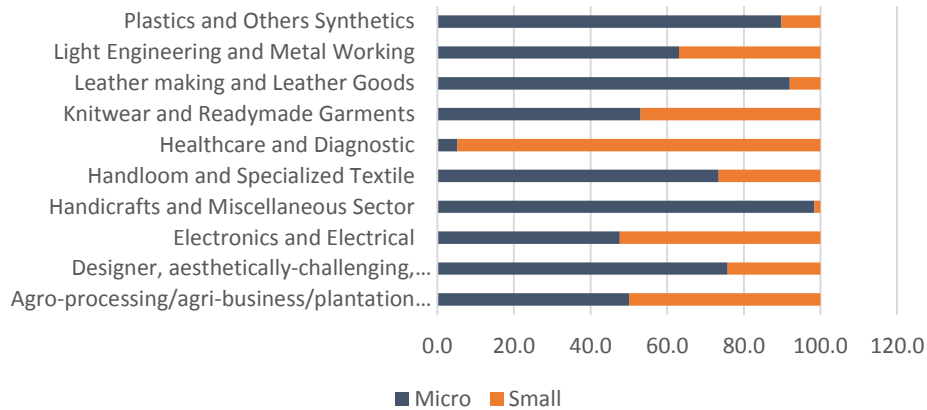
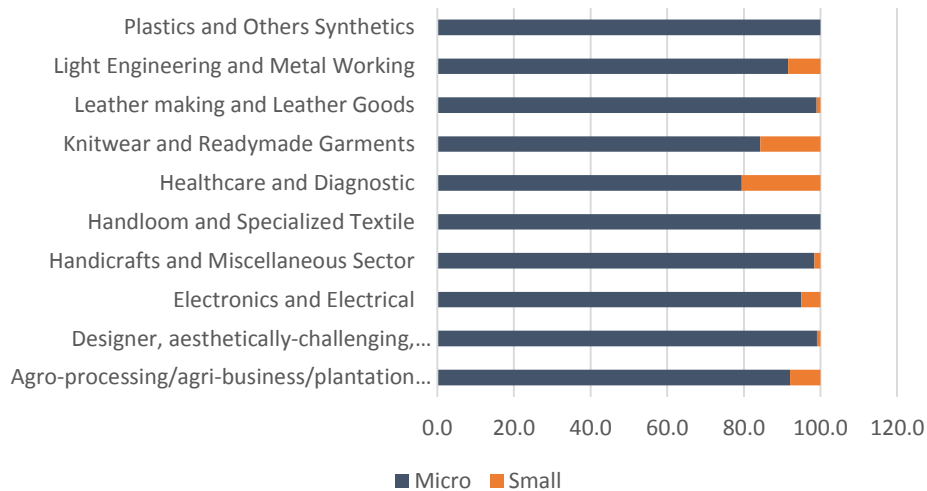


Figure 5: Sectorwise percentage distribution of micro and small enterprises in the backward and the forward market chain

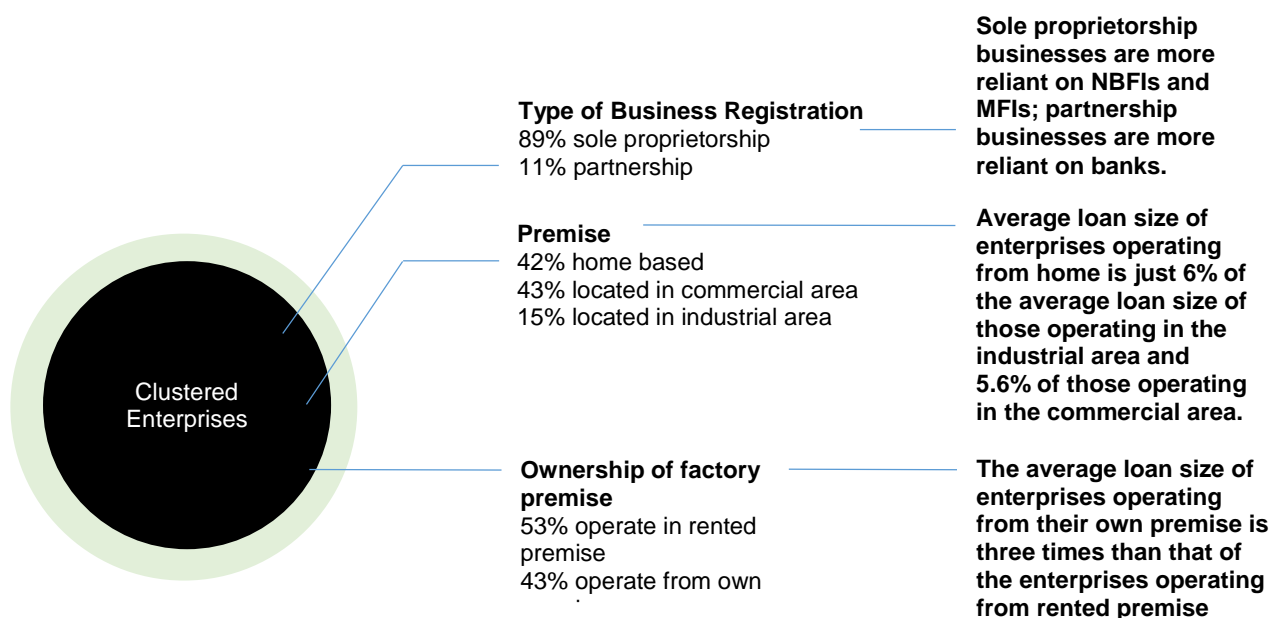


## 2.2 Business Profile of the Enterprises in the Clusters

The enterprises in the clusters are mostly heterogeneous groups. Overall, 89% of the respondent manufacturing enterprises are sole proprietorship; 11% are partnership businesses. 42% of the enterprises in the selected clusters are home based and about 43% are located in commercial area with only 15% located in industrial areas. 53% of the MSMEs in the clusters operate from rented premises. 47% operate from their own premises. 66% of the enterprises have trade license. 53% of the respondents do not have membership with trade associations. Findings show that there is positive correlation between type of business registration, location of the enterprise and ownership of the factory premise. Furthermore, there is positive correlation between access to finance and ownership of trade license and membership with trade associations. The average loan size of sole proprietorship

businesses is BDT 22.02 lacs. In contrast the average loan size of partnership businesses is BDT 35.56 lacs. Average loan size of limited liability companies is BDT 90 lacs. 69% of the partnership businesses are reliant on banks for financing. In comparison, 28% of sole proprietorship businesses are reliant on Banks for financing. 27% of the sole proprietorship businesses are reliant on NBFIs while about 21% are reliant on MFIs. The average outstanding loan size of enterprises operating from their home is BDT 241,389. In contrast it is BDT 34,67,768 for enterprises operating in industrial area and BDT 42,88,280 for enterprises operating in commercial area. The average loan size of enterprises operating from their own premise is BDT 31.93 lacs. The average loan size of enterprises operating from rented premise is BDT 13.89 lacs. These findings show that there is a need for differentiated financial instruments to serve the financial needs of these enterprises.

**Figure 5: Correlation between financial need and business profile of the MSMEs in the clusters**



The loan size varies between the MSMEs as per their business registration, business premise and ownership of the business premise. Differentiated financial services are essential since the MSMEs are not at the same level playing ground. Sectoral differences need to be accounted for in this context.

Figure 6: MSME Distribution as per business registration

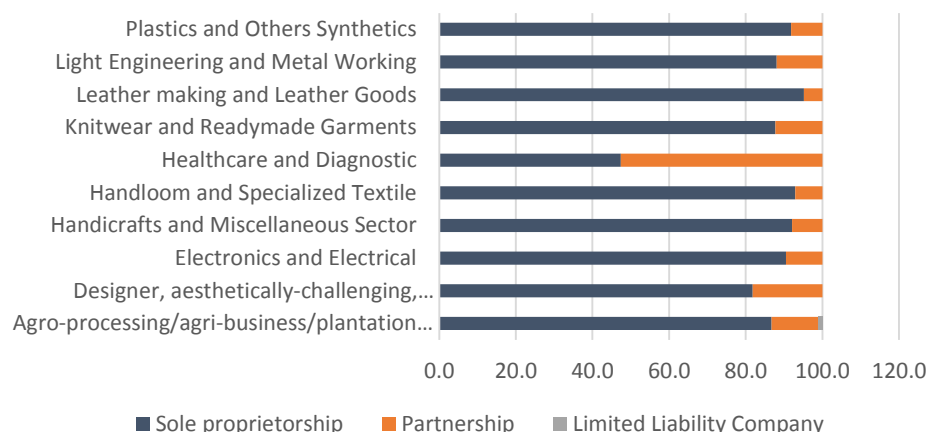


Figure 7: MSME Distribution as per location of the business premise

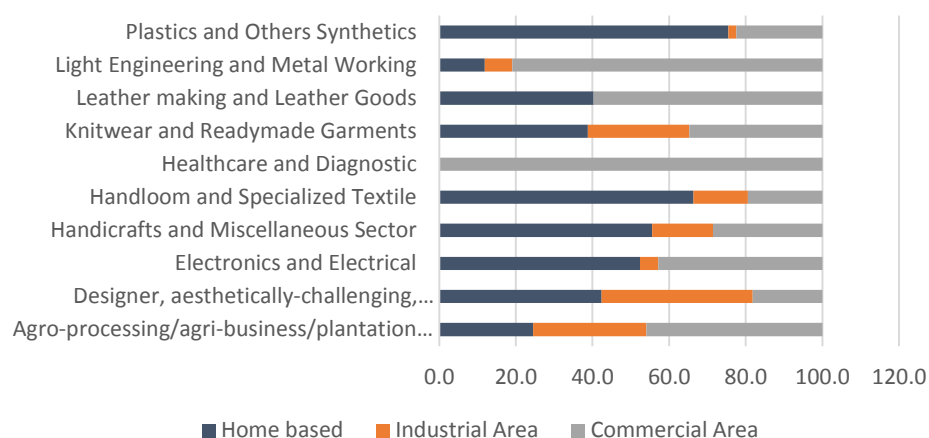
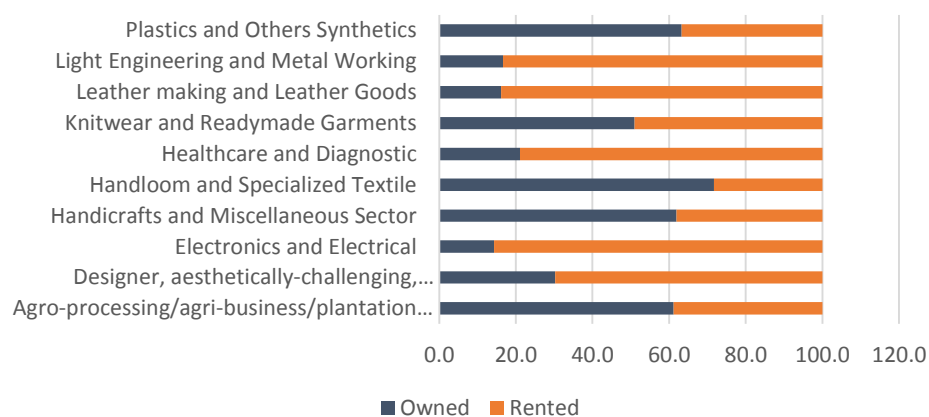


Figure 8: MSME Distribution as per ownership of the business premise

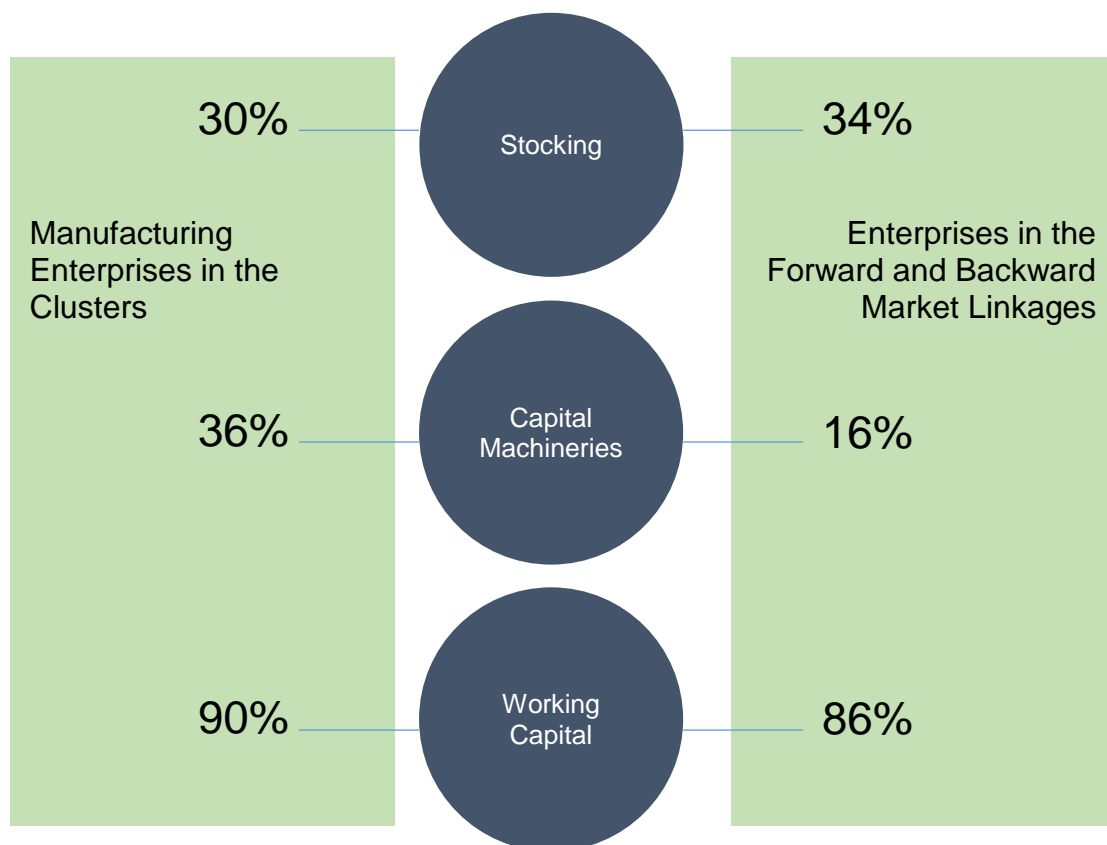


## 2.3 Financing Needs of the MSMEs

The financing need of the MSMEs vary. 90% of the manufacturing enterprises in the clusters want finance to invest on working capital; 36% want finance to invest on new

machineries and 30% want to invest on increasing stock. Amongst the enterprises in the backward and forward market linkage 86% want finance for working capital; 16% for capital machineries and 34% for stocking.

**Figure 9: MSME Financing Needs**



Term loans are more suitable for stocking than overdraft. Lease financing is suitable for capital machineries while time loan or demand loan is suitable for working capital. However, most of the MSMEs are sole-proprietorship and thus banks are reluctant to provide term loans without mortgage which most of the enterprises are not able to provide. Besides, for time loan, it is essential that the MSME cash cycle is predictable. Most of the MSMEs do not have control on their cash cycle. MSMEs also often do not have formal contracts or work orders. To mitigate these challenges hybrid financing models that combine term loans and overdrafts could be more suitable for working capital finance and stock finance.

## 2.4 Finance Secured and Source of Finance

The findings show that there are larger number of MSMEs who have never secured external finance for their business. Furthermore, almost half of the enterprises do not have active loans with formal institutions. We can construct two possible scenarios based on this- (i) the MSMEs do not need external finance or (ii) MSMEs are not able to secure finance from formal sources and are therefore dependent on other sources. We examined both cases further in this section.

Figure 10: Distribution of manufacturing enterprises with currently active loans

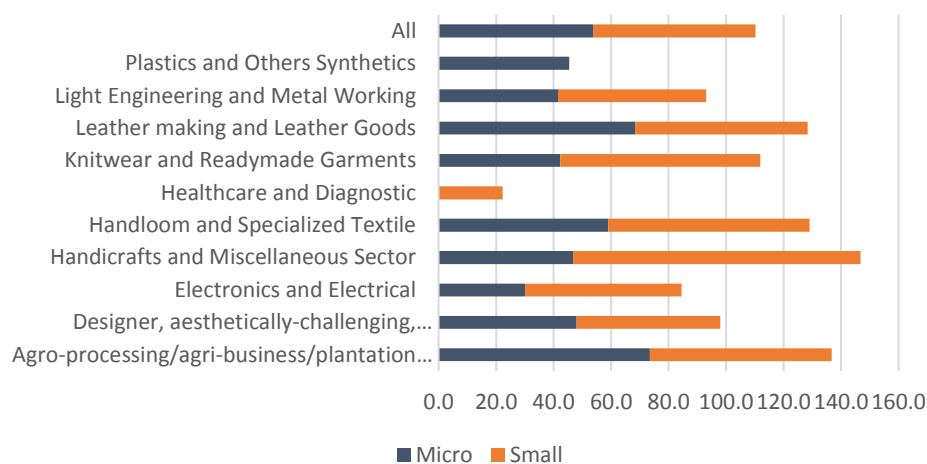
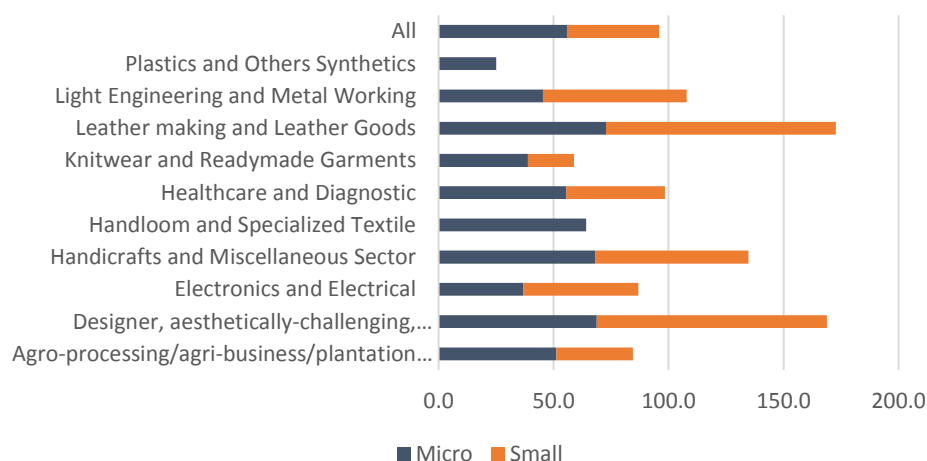


Figure 11: Distribution of forward and backward chain enterprises with currently active loans

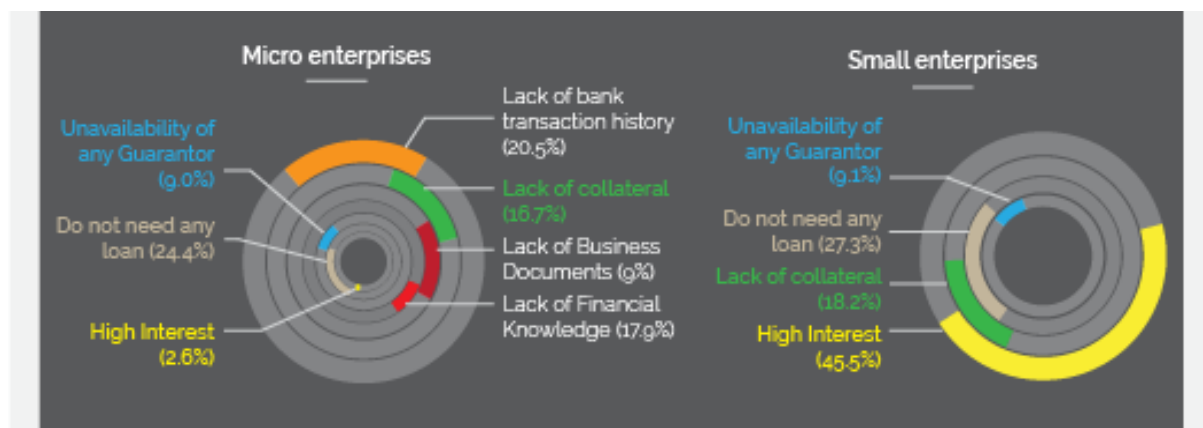


34.7% of the surveyed enterprises never secured any external financing. The incidence is higher amongst the micro enterprises in comparison to small enterprises. Of those who never

secured external financing, 71% are micro enterprises. Findings further show that almost half of the manufacturing enterprises and the enterprises in the forward and

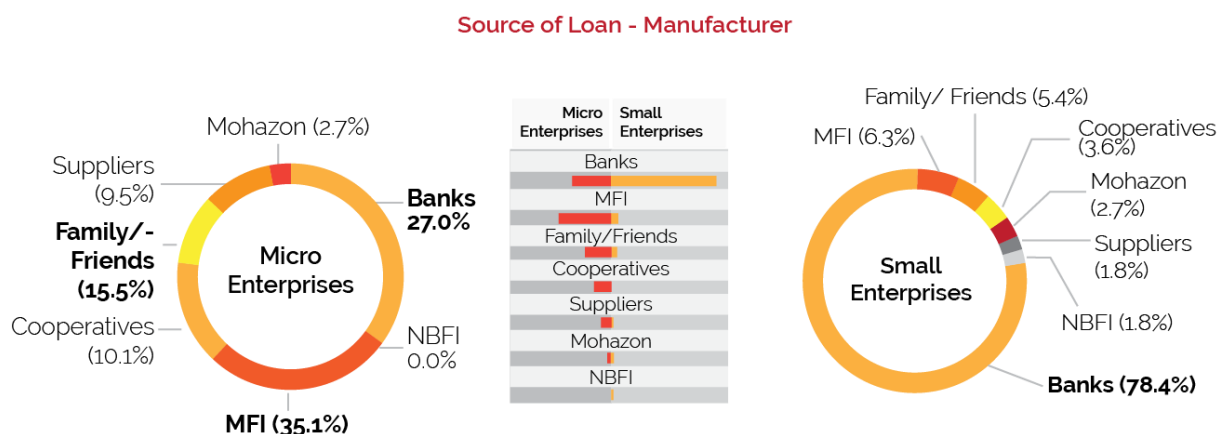
backward market chain do not have active loans. Furthermore, there is variance between micro and small enterprises with respect to having active loans. In the light engineering and metal working clusters, knitwear and ready made garments cluster, handicrafts and miscellaneous sector clusters and electronics and electrical clusters, higher percentage of small enterprises have active loans if compared to micro enterprises. In the forward and backward market linkages, higher percentage of micro enterprises have active loans with the exception of micro enterprises in the electrical and electronics cluster, leather making and leather shoe cluster and light engineering and metal work clusters. The key

reasons for the micro enterprises for not securing external finance are (i) lack of bank transaction history (20.5%); lack of collateral (16.7%) and lack of financial knowledge (17.9%). Large number of micro enterprises reported that they do not need external finance (24.4%). The key reasons for the small enterprises for not securing external finance is high rate of interest (45.5%) which is followed by lack of collateral (18.2%). About 27.3% of the small enterprises reported that they do not need loan for their business. Based on the findings from the FGDs we can attribute the lack of demand for financing to the fact that large number of enterprises prefer to do business on cash and therefore prefer to have shorter business cycles.



MSMEs in the clusters meet their financing needs through diverse sources. This include the formal financing sources (banks, NBFIs, MFIs) and informal sources (friends and family members, mohazons, relatives). We can observe variance amongst the micro enterprises and the small enterprises with respect to their sources of finance. Micro enterprises are more reliant on MFIs while small enterprises are more reliant on Banks. Micro enterprises also have higher incidence of securing finance from family and friends, cooperatives and suppliers.

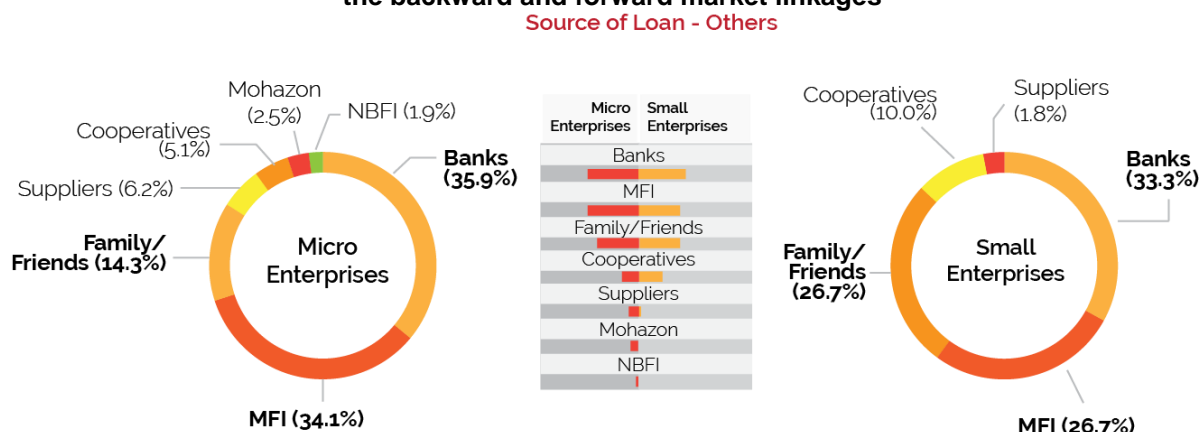
**Figure 12: Source of loan for the manufacturing micro and small enterprises in the clusters**



In the backward and forward market linkages, micro enterprises are reliant on both banks and MFIs. Similar trends are being observed with small enterprises in the backward and forward market linkages. However, small enterprises are more reliant on banks in comparison to MFIs. Interestingly, higher percentage of small enterprises are reliant on family and friends.

Family and friends are also a major source of finance for micro enterprises in the backward and forward market linkages. This can be attributed to the fact that the enterprises in the backward and forward market linkages have short term cash requirement which they try to fulfill through their friends and families even if the interest rate is higher.

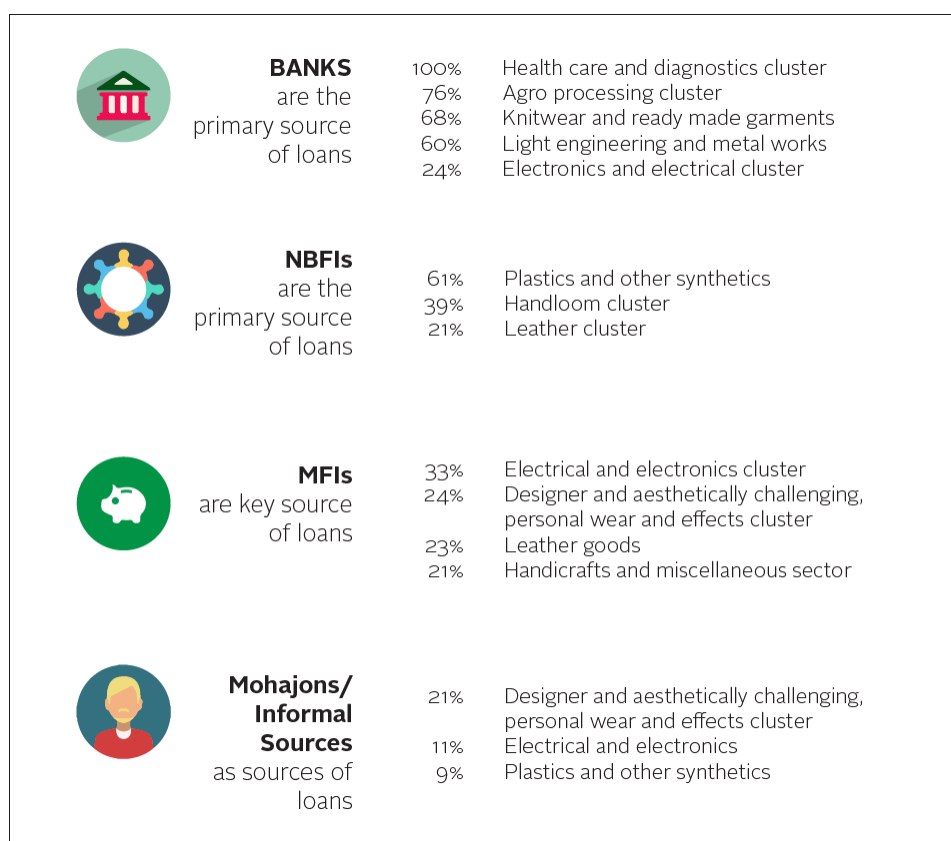
**Figure 13: Source of loan for the enterprises in the backward and forward market linkages**



We can also observe difference amongst the enterprises with respect to their source of finance if we compared the sectors. Banks are the primary source of loans for the enterprises in the Agro processing cluster (76%), health care and diagnostics cluster (100%), electronics and electrical cluster (24%), knitwear and ready made garments cluster (68%), light engineering and metal working cluster (60%). NBFIs are the primary source of loans in the handloom cluster (39%), leather cluster (21%) and plastics and other synthetics cluster (61%). Although the MFIs do not dominate as the primary source of finance for the MSMEs in the clusters, they are one of the key sources for the MSMEs in the electrical and electronics cluster (33%), designer and aesthetically challenging, personal wear and effects cluster (24%), handicrafts and miscellaneous sector cluster (21%) and the leather goods cluster (23%). Incidence of

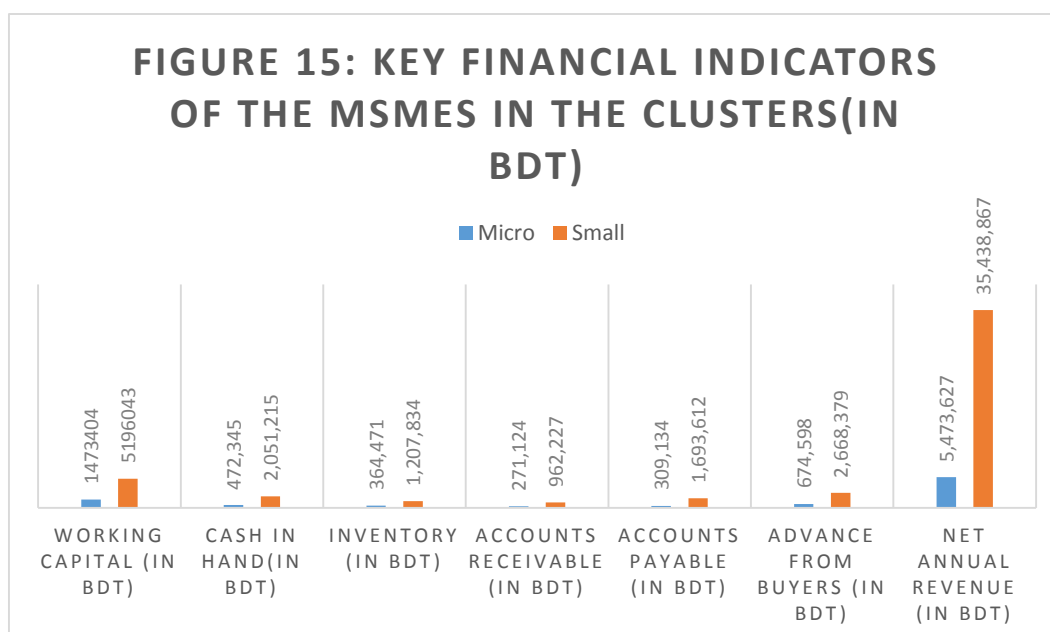
sourcing loans from Mohajons or informal money lenders is high among the enterprises in the designer, aesthetically challenging, personal wear and effects cluster (12%), electrical and electronics cluster (11%) and plastics and other synthetics cluster (9%). The trends could again be attributed to the business transactions in the sector. Sectors that have larger number of micro enterprises, shorter business cycles and short term loan requirements are more reliant on MFIs and informal sources. Whereby sectors that have larger number of small enterprises, longer term business cycles and long term financing needs are more reliant on banks and NBFIs.

**Figure 14: Sector wise distribution of major sources of finance**



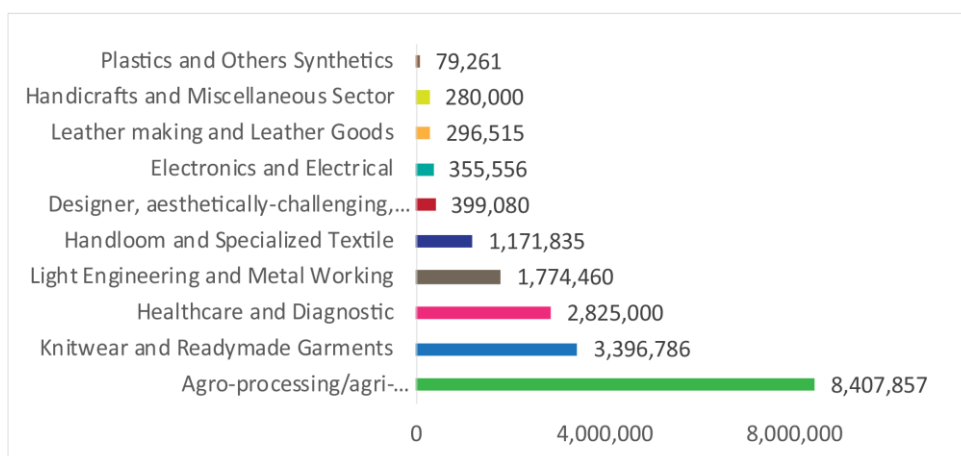
To understand the business cycle of the MSMEs, we looked at their working capital turnover ratio. Generally, small enterprises have higher working capital turnover (6.82) if compared to micro enterprises (3.71). The comparatively

weaker working turnover ratio of the micro enterprises mean that they are less attractive for financing to the commercial banks if compared to the small enterprises.



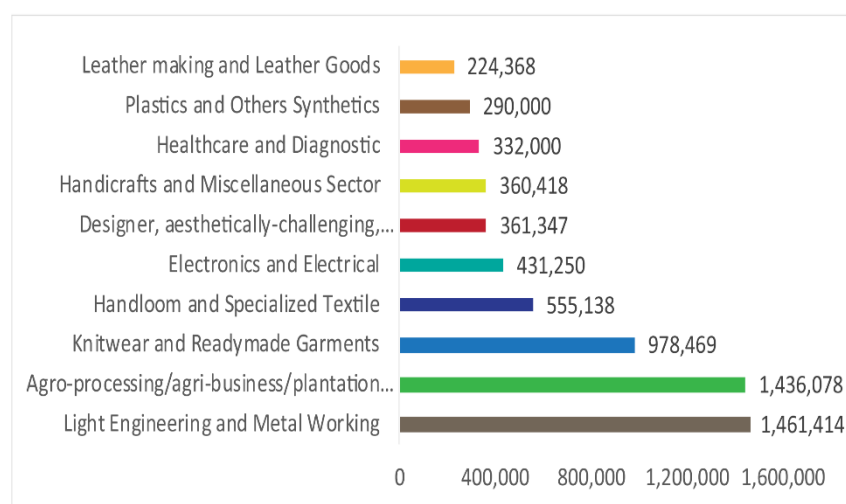
**Figure 16: Comparative analysis of average loan amount amongst the manufacturing enterprises**

Average Loan Amount (All Enterprises - Manufacturer)



**Figure 17: Comparative analysis of average loan amount amongst the enterprises in the forward and backward market linkages**

Average Loan Amount (All Enterprises - Other)



## Snapshot: Mode of business transactions of the MSMEs

### Light Engineering and Metal Working Clusters

MSMEs procure locally produced raw materials and machineries on cash and imported raw materials by opening LC accounts. Internal value chain financing is a dominating practice. Raw material suppliers provide credit facility based on business relation with producers. The enterprises do not keep ready stocks. The products are produced based on order and sold on credit. Usually the payment is released after 3 to 4 months; once the quality of the products is tested. For irregular items, the buyers sometimes make advance payment (10-13%). To secure orders, MSMEs often compete with each other by offering extended credit to the buyers. Larger credit terms and longer payback period attract more buyers for businesses. The minimum size of an order is BDT 500,000 while on average the MSMEs receive orders worth BDT 700,000 to BDT 800,000.

The MSMEs in the light engineering clusters are mostly matured businesses and hence they do not require start-up financing. They however require financing for expansion of their facilities which is

increasingly being financed through lease financing arrangements by non-banking financial institutions. Working capital is primarily financed through CC loans and terms loans. The duration of term loan is short (2 years or low) which has reduced its effectiveness and attractiveness to the enterprises. They are increasingly using CC loans to finance working capital requirement. However, large number of enterprises are not able to secure CC loans because of their inability to offer collateral. Most of the MSMEs do not have formal work orders. They also do not have invoices. This constrains the capability of the MSMEs to secure work order financing in the form of tripartite agreement between the MSMEs, the buyers and the banks. In 2016, SMEF disbursed single digit interest loans from the Credit Wholesaling Program. The loans ranged from BDT 500,000 to 1,500,000. A handful of MSMEs received this financing scheme through IDLC and MIDAS. This was facilitated through BEIOA. The fund is currently not available to the cluster.

## Electronics and Electrical Cluster

The MSMEs in the clusters consider the taxation policies as constraining to their business growth. They thus generally avoid the banking channels for their business transactions and operate on cash basis. They also do not maintain standard books of accounts. The MSMEs have to pay dice producers in advance for the product. However, they have to sell their products on credit to the wholesalers. These means, the MSMEs often have liquidity crisis. The accounts for the credit sales are never closed as the wholesalers pay in cycles. Thus the credit keeps rolling.

The enterprises are primarily managed by the owners who prefer not to employ full time managers to maintain profitability. This suggests the highly competitive nature of the industry and the low profit margin for the manufacturers. This is also exhibited on the value chain which shows the dependence of the small and medium enterprises on the wholesalers to secure domestic institutional or retail market. This further contributes to the MSMEs lack of interest in transacting through banks.

Since the enterprises do not maintain any formal accounts neither conduct transactions through banks, they are not able to generate records of cash flows. This deprives them of the ability to take loans from banks as banks are not able to assess credit worthiness of the enterprises. Furthermore, SMEs often do not have the required documentation (for instance trade license and TIN) to meet the loan compliance. Consequently, entrepreneurs in this sector resort to loans from MFIs and loans from family and friends. MFIs have simple loan requirements which can be easily met however the cost of loan is significantly high. MFIs typically charge 20 to 25 per cent interest rate on loans and require weekly or monthly equal instalments. FGD participants have mentioned Sajida Foundation as a lender of microcredit loans. The loan size is usually in the range of TK 100,000- TK 1 million. The SMEs usually take the loans for purchasing raw materials and machinery.

## Mirpur Benarasi and Narayanganj Jamdani Cluster

In case of outsourcing, the large weavers in the Benarasi Cluster provides TK 1-2 lacs as security to the contracted weavers. In case of Jamdani, the security paid to the contracted weavers is TK 0.5 to 1 lacs. The contract period is usually for one year. This advance has to be paid back to the contractors at the end of contract period. Within this period, the contractor has to pay the weavers wages for each garment produced. Payment for the garment is made partially in advance (40% to 50%) and the rest upon delivery of the product. The weavers purchase yarn and other inputs such as karchupi, dye etc. partially (70%) on cash and the rest remain as revolving credit which is adjusted in 7-10 days.

From the FGDs we found that a typical Jamdani weaver has TK 5 to 6 lacs investment on inventory. Advance for shop and decoration requires substantial amount of investment especially for Benarasi traders. A typical Benarasi shop decoration requires TK 5 to 10 lacs. It costs TK 2 to 5 lacs for Jamdani shop. Some of the manufacturers own Tant which cost around BDT 10,000 for each loom. On average a Benarasi weaver owns about 5-10 handlooms; a Jamdani weaver owns about 5 handlooms. The weavers finance their capital investment and working capital investment primarily from their own income or savings. Incidence of borrowing from banks is very low. The weavers do not own fixed assets building and land. They operate in rented premises and lack the ability to place mortgage with banks. Furthermore, the weavers reported that they do not understand the interest rate calculation and its impact on their income and profitability. This shows the weak financial literacy amongst the weavers.

Weavers who approached banks for loans reported of long waiting time as a deterrent to seeking loans from formal financial institutions.

### Tangail Handloom Cluster

Hand loom and power loom weavers finance the industry set up and machinery installation cost by equity investment. The start-up of a typical power loom with 6 looms would cost BDT 600,000 (BDT 100,000 for each power loom and BDT 50,000 for each handloom); BDT 100,000 for civil infrastructure and another Tk. 200,000 for raw materials adding up to Tk. 900,000 total. Some of the weavers take informal loan from relatives and fellow businessmen. Most take loans from the local MFIs. We found in our qualitative study that currently 50% of the handloom and power loom units have outstanding loan from MFI. These units prefer MFIs for external financing since they are unable to pay mortgage to the banks. Apart from MFI loans, the weavers rely heavily on product financing. About 90% of the weavers purchase yarn on credit. They have to pay an additional price of TK 20 per kilo yarn for credit purchase instead of cash purchase. It is a revolving credit arrangement where manufacturers purchase yarn on credit, produce and sale fabric and pays back the loan within 7 to 30 days. The finished products are sold on cash. Yearly turnover of a single handloom ranges from BDT 100,000 to 150,000 and a single power loom ranges from BDT 360,000 to 600,000.

### Sherpur Rice Processing Mill Cluster

Farias and in some cases Mokam directly collect paddy from the farmers in local haats. Transaction between these two actors takes place in cash. Faria supplies to mills directly or via Mokam. The transaction between mill and Mokam/Faria also takes place mostly in cash except few on credit based on personal relations which lasts for 10 to 30 days. The transactions for processed rice between mill and Rice traders take place on credit and credit last for 30 to 45 days and it is a revolving credit arrangement. Similar transaction happens between wholesale traders and nationwide retailers. All the support services mentioned is availed in cash.

Generally, for factory set-up owners invest equity capital for purchasing land and partial construction of building. Afterwards they approach for bank loans. Accept the investment in land; an auto-rice mill requires BDT 200 million for building construction and machinery set-up. Semi-auto rice mill requires BDT 15 million to 20 million for the same. Rice mills also need large working capital investment for stocking rice during the harvesting season; Aman harvesting season in September to December and Boro harvesting season in April to Jun. For working capital large mills (auto and semi-auto mills) have Cash Credit (CC) arrangements with commercial banks located in Sherpur, Bogra. Auto rice mills have monthly sale of BDT 5 to 10 million and during season they keep on an average inventory stock of BDT 20 million. Monthly sale for a semi-auto rice mill is BDT 1 to 2 million and they keep stock of BDT 5 million. Small units such as husking mill usually invest of their own and in some cases take informal loan from relatives and friends. These units generally do the boiling, drying and husking function and take service charge for those. Monthly revenue of a husking mill ranges from BDT 0.1 million to 0.5 million and generally they maintain small stock of inventory. Large traders such as paddy Mokam and wholesale rice traders also have CC arrangements.

## 2.6 MSME Usage of Bank Account

The incidence of owning and operating company bank account is almost similar amongst the enterprises in the backward and the forward market chain. 60% of the backward and forward market actors reported to have bank accounts in the name of the business. Almost all (98%) of those who have business accounts, use the account in business transaction. Backward and forward market actors use bank account for business transaction because bank transaction is secured (84%); bank transaction helps to avail loan (48%) and other value chain actors requires or prefers bank transaction (27%).

Use of bank accounts for business transaction is still not universal amongst the enterprises. 62% of the respondent MSMEs have company bank accounts. The incidence of owning company bank account is low in the handicrafts cluster (38.1%), plastics and other synthetics cluster (42.9%) and the handloom and specialized textiles cluster (47.8%). 52% of the respondents reported that they use bank accounts since it is secured. On the flipside, 68% of the MSMEs who reported of not using bank accounts reported that they

prefer to transact through cash. This refers the mind-set of the enterprises for preferring cash transaction over bank account

transaction. The case of cash based transaction could be further explained from our FGD in the plastics and other synthetics sector.

### **Snapshot: Cash based transaction in the plastics and other synthetics cluster**

The enterprises procure raw materials for cash. Credit facilities are seldom extended; however, they carry a surplus charge. Thus the producers of plastic goods prefer to pay in cash directly upon delivery of raw materials. Machinery is also purchased on cash. The finished products are sold on credit. Payment is typically received 30 to 45 days after delivery for enterprises in Kamrangichar. In case of enterprises in the Islambagh cluster, LC is opened by the RMG factory against an international LC account. Payment for the goods is received 5 to 6 months after opening the LC. It can be concluded here that contract manufacturing involves credit payment. In case of own-account manufacturing goods are sold on credit to wholesalers. The payment system is disadvantageous for enterprises as it is a wholesaler's market and they exploit the credit terms. There is no timeline followed for clearing credits and the amount keeps revolving. It is unhealthy for entrepreneurs as it constrains their working capital. Enterprises usually plough back the receipts from sales as working capital.

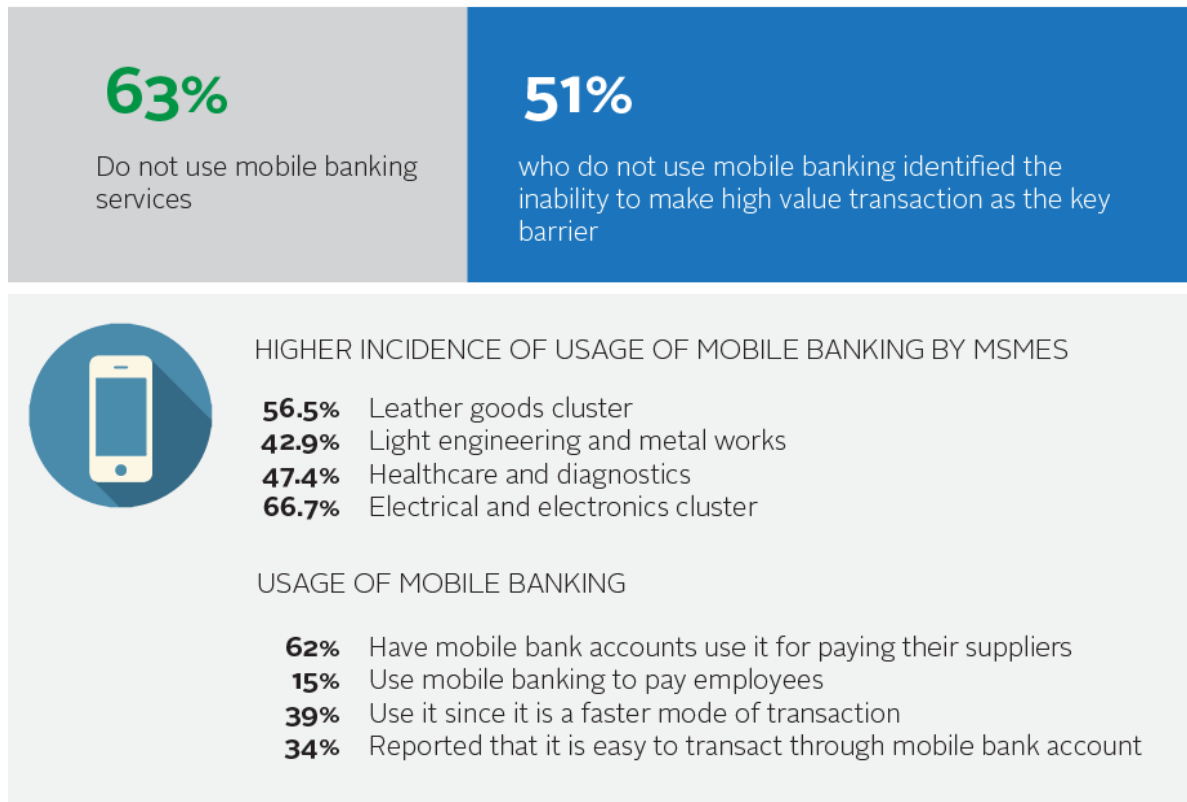
## **2.7 MSME Usage of Digital Financial Services**

37% of the MSMEs in the clusters have mobile banking account. The incidence of using mobile banking service is higher amongst the MSMEs in the leather cluster (56.5%), light engineering and metal works cluster (42.9%), healthcare and diagnostics cluster (47.4%) and electrical and electronics cluster (66.7%).

62% of the MSMEs who have mobile bank accounts use it for paying their suppliers. 15% use mobile banking to pay employees. 39% of the MSMEs who have mobile bank accounts reported that they use it since it is a faster mode of transaction. 34% reported that it is easy to transact through mobile bank account. Inability to make high value transaction is considered as the major barrier in using mobile banking. 51% of the respondents who do not use mobile banking for business transaction identified the inability to make high value transaction as the key barrier. This possibly indicates that the MSMEs are not aware of merchant bank account for business transactions.

Comparatively higher percentage of the MSMEs in the backward and forward market linkages are using mobile banking account. 41% of the MSMEs in the backward and the forward market linkages are using mobile banking account. The incidence is highest amongst the respondents from plastic cluster (100%), electronic cluster (73%), handloom cluster (72%) and in the knitwear cluster (68%). Those who have mobile banking accounts use it mainly for paying receivables (76%) and 13% use it for paying salaries and wages. Among those who use mobile banking accounts in their business reported faster transaction (80%), ease of transaction (63%) and availability of vendors (46%) as the main reason for using mobile banking accounts. Among those who do not use mobile banking accounts pointed out high transaction cost for large transaction as the restricting factor for using mobile banking accounts.

**Figure 18: Use of mobile banking services amongst the MSMEs in the cluster**



## 2.8 Financial Literacy of the MSMEs in the Clusters and the Value Chains

Assessment of the financial literacy of the MSMEs in the clusters and in the value chains show that the MSMEs are aware of the interest rates for the loans, the loan tenure and the type of loan that they are availing. However, the MSMEs across the value chain lack knowledge on grace period, security requirements.

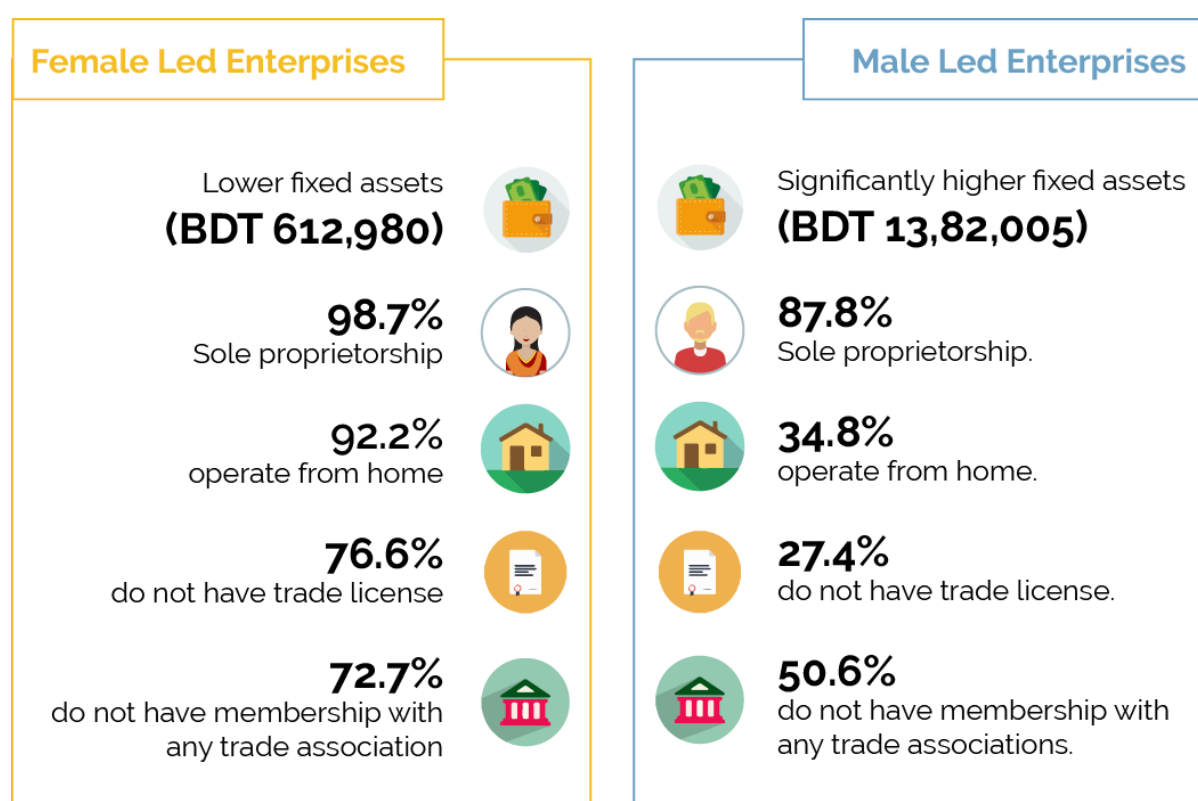
70% of the manufacturing MSMEs could correctly explain the interest rate for the loans.

82% of the MSMEs could not define the grace period. 65% of the MSMEs could not explain the security requirements. 56% of the MSMEs could define the type of loan that they are availing. The trend is almost similar amongst the enterprises in the backward and the forward market value chain. 74% of the backward and forward market actors have been able to explain interest rate correctly and 62% explained loan tenure. However, 80% of the respondents lack knowledge about grace period and 59% lack knowledge about security requirements

## 2.9 Review of access to finance of the women entrepreneurs in the clusters and the value chains

93.5% of the respondent female enterprises belong to the micro-enterprise category. The female led enterprises have significantly lower fixed assets (BDT 612,980) if compared to male led enterprises (BDT 13,82,005). 98.7% of the female led enterprises are sole proprietorship. In contrast 87.8% of the male led enterprises are sole proprietorship. 92.2% of the female led enterprises operate from home. In contrast, 34.8% of the male led enterprises operate from home. 76.6% of the female led enterprises do not have trade license while 27.4% of the male led enterprises do not have trade license. 72.7% of the female led enterprises do not have membership with any trade association. 50.6% of the male led enterprises do not have membership with trade associations. Female led enterprises are more dependent on MFIs and friends and family for financing. 42% of the female led enterprises secure finance from MFIs; 21.1% secure finance from friends and family; 23.7% secure finance from Banks. Female led enterprises are lagging behind. Why so?

**Figure 19: Comparative status of key financial and business indicators of the female led enterprises and the male led enterprises**

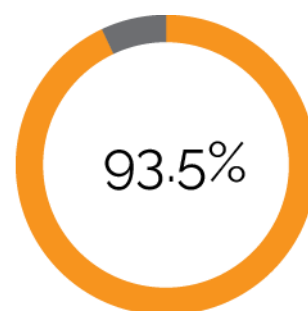


Our findings show that the women entrepreneurs are mostly concentrated in small low value added clusters where they work primarily as wage earners. Examples include the women entrepreneurs engaged in the export oriented basket making cluster in Pirojpur or the cotton thread production cluster in Comilla. They are barely represented in the industrial clusters, for instance light engineering, agro processing, plastics, leather shoes and such. Our assessment with PKSF and the microfinance institutions however show a more positive scenario with respect to participation of women. Such clusters include crab fattening in Shatkhira, shataranchi in Rangpur, Omani Cap making cluster in Gaibandha and such. However, here too we can observe that the women are primarily engaged as wage earners.

The capacity of the women entrepreneurs to scale up their business operations through cluster or value chain financing is low in this context. While some women do take MFI loans and engage other women as their subcontractors, most take loans to diversify their income generating activities by investing in livestock and poultry business, fisheries business and such. Further to that, our findings show that the capacity for vertical expansion (by increasing productivity) is low for the women entrepreneurs in such trade given that their primary input is their own labor and they can do only as much. Our findings show that the women enterprises who are being engaged in the basket making cluster in Pirojpur earn just about TK 160 in 2 days. Their total income from the vocation does not exceed more than TK 2400 over a month.

In the urban areas, we observe almost a similar trend. However, a key difference here is that the enterprises are bigger in scale and there is scope for expansion through finance. Vocations or trades where women entrepreneurs are engaged in urban areas include embroidery and tailoring shops, boutiques, salons, home made food items, online fashion and jewellery stores and such. Women engaged in such businesses are well represented by organizations like BWCCA and WVA. MIDAS has long been engaged in financing women entrepreneurs in urban areas which includes Dhaka. Our discussion with MIDAS revealed some interesting insights to understand the issues that the women entrepreneurs face with respect to financing

their businesses. According to MIDAS, women entrepreneurs primarily engage in businesses as a part time vocation. They therefore prefer trades that they can run from their home. Often they start informally and thus they don't make any trade license. The transactions are done through their personal bank accounts. After several years, when the business show growth prospect, the application for trade



of the respondent female enterprises belong to the **micro-enterprise** category.



Female led enterprises are more dependent on MFIs and friends and family for financing.

**42%**

of the female led enterprises secure finance from MFIs;

**21.1%**

secure finance from friends and family;

**23.7%**

secure finance from Banks.

license is produced. At the same time, the business loan is also solicited. The FIs in such cases are unable to honor the application as the business fails to proof the creditworthiness.

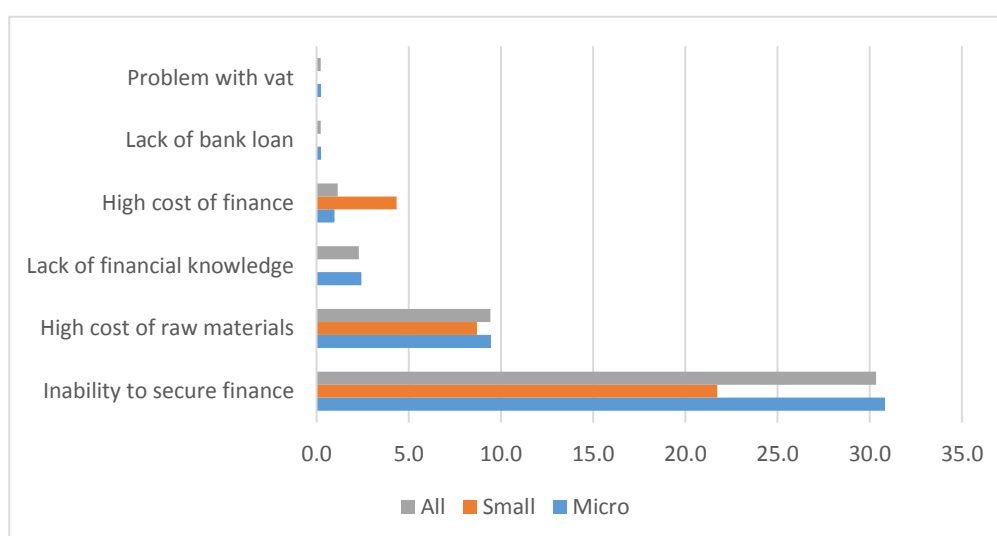
From these findings, it can be ascertained that to effectively facilitate women entrepreneurship through financial intervention, it is imperative to identify sectors where there is specific scope for expansion or business growth of women entrepreneurs. As the women entrepreneurs are concentrated in trades that are operated from their home, there is no effective clusters of

such trades where cluster based financing could be introduced. However, the government might take initiative to set-up special zones for women entrepreneurs where they can share office space with a common finance department that serves multiple enterprises at a time. Such shared space could be used to address the challenges related to business documentation and maintenance of book of accounts. Furthermore, this could be used as an entry point by FIs to reach women entrepreneurs to market their schemes.

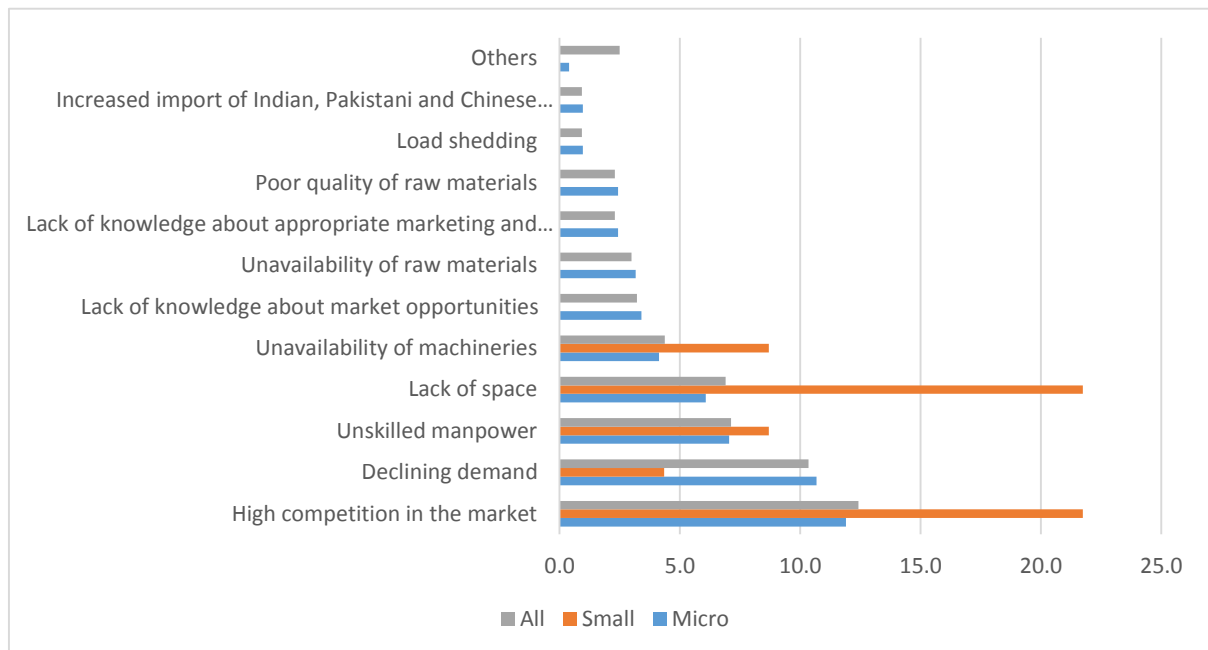
## 2.10 Financial and non-financial barriers that restrict MSME growth and competitiveness

Our findings show that finance is one of the barriers that restrict the MSMEs to grow their businesses. There are other non-financial barriers that limit their growth prospect. This includes high cost of the raw materials, unskilled manpower, high cost of machineries, high competition in the market, lack of space for business expansion and declining demand. The scope for cluster and value chain financing in this regard should be seen not only from the perspective of finance but on the perspective of the scope of addressing both financial and non-financial barriers for MSME growth and competitiveness.

**Figure 20: Financial barriers for MSME growth and competitiveness**



**Figure 21: Non- Financial barriers for MSME growth and competitiveness**



### 3. Analysis of the Prospect for Cluster and Value Chain Financing

To analyse the prospect for cluster and value chain financing we used two indicators. Financial readiness and unmet financing needs. The clusters that were investigated were scored in a scale of 1-5 with 1 being low

and 5 being high. The scores were used to plot the clusters on a matrix scale using two coordinates- (i) financial readiness on the X axis and financing needs on the Y axis.

#### Indicators for Measurement

**Financial readiness:** This was measured by the degree of usage of bank accounts, business registration type (sole proprietorship, partnership and limited liability company), ownership of trade license, membership of trade association and such. Furthermore, current access to and use of financial services was also used as an indicator for financial readiness. Sectors with higher percentage of enterprises availing financial services from formal institutions scored higher.

**Financing needs:** This was measured by the working capital turnover ratio, inventory turnover ratio, liquidity gap and such. Sectors that have lower working capital turnover and inventory turnover scored higher in terms of financing needs. Furthermore, we took into account the average loan size that is being solicited by the enterprises in the clusters and the value chains. The growth prospect of the clusters was taken as a contributory factor to financing needs. The growth prospect was measured by demand trends in the national and international market (if applicable), supportive investment from the government and the development partners.

#### Grading Index

**Boost:** The opportunity is immediate and the financial institutions could promote cluster and value chain financing products without significant institutional support from government agencies.

**Grow:** The opportunity is immediate but the financial institutions require institutional support from the government agencies to create a market for the cluster and value chain financing.

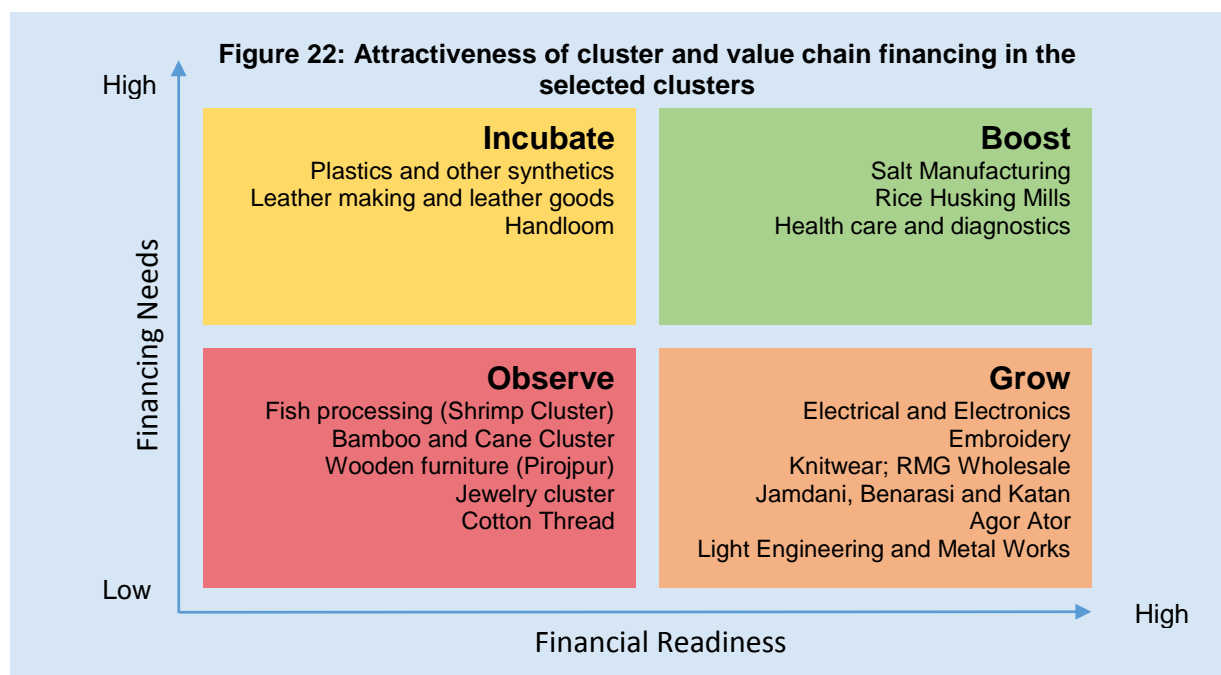
**Incubate:** The prospect for cluster and value chain financing is not immediate. Infrastructural and capacity development support by BB and SMEF could facilitate demand for cluster and value chain financing in the long run.

**Observe:** Financial institutions will not be able to create a market for cluster and value chain financing in these clusters given the current and prospective growth of these clusters.

We used the quantitative data and qualitative information collected from the field to grade the clusters that were selected for the purpose of the study. The review suggests that the immediate prospect for cluster and value chain financing exist in the salt manufacturing, rice husking mills and health care and diagnostics clusters. The regular financial instruments (term loans, CC loans etc.) could be promoted in these clusters in addition to factoring, warehouse receipt and such.

The opportunity for cluster and value chain financing is also immediate in the electrical and electronics, embroidery, knitwear, RMG wholesale, Jamdani, Benarasi and Katan, Agor Ator and Light Engineering and Metal works clusters. But these clusters would require public and private sector intervention to develop common facilities, common infrastructure and alternative financing instruments (For instance Special Purpose Vehicles) to make the enterprises grow.

The prospect for value chain and cluster financing is not immediate in the plastics and other synthetics, leather making and leather goods and handloom clusters. The enterprises in these clusters face significant non financial barriers that need to be addressed. For instance, investment in the leather and leather shoe making cluster is currently limited due to uncertainty resulting from planned relocations. The prospect for cluster and value chain financing is not immediate and relevant to several clusters. This includes fish processing cluster in Rupsha (Khulna), Bamboo and Cane Cluster (in Jessore), Wooden Furniture (in Pirojpur), Jewellery Cluster (in Mymensingh) and the Cotton thread cluster (in Comilla). These clusters face varying degree of challenges that cannot be solved through cluster and value chain financing. For instance, the women crafts producers (basketry) in Jessore are engaged in production of hand made export oriented baskets. The demand for the product is low and the ability of the enterprises to expand their business is limited since the business is dependent on their own manual labor. In the shrimp cluster, the government's special subsidy programmes already exist to facilitate finance for the enterprises.



## Snapshot: Cluster and Value Chain Specific Prospects for Financing

Boost	
Cluster	Scope
Salt Manufacturing Cluster (Majhirghat)	<p>Salt processing units need to invest substantial in inventory since they purchase raw material in cash and sell processed salt on credit. Majority of the salt processing units meet up working capital requirement with bank loans and have working capital arrangement (CC) with commercial banks. However, there is un-met demand for working capital loans since these units face challenges in placing security. As the factory premise is rented they have to mortgage own property. In most of the cases salt processing units have land or building outside Chittagong which banks do not accept as collateral. For example, an average sized salt processing unit in the cluster requires CC limit of BDT 10 million whereas, they are currently availing BDT 1 to 5 million of limit.</p> <p>In the backward linkage area, suppliers and agent to the processor do not require vast working capital since they sell salt to the processors in cash and pays cost of goods sold to the farmers after realization of sale revenue. In the forward linkage, wholesale traders are generally large trading corporation and have working capital arrangement with the banks. Banks need to explore these traders for their un-met demands with their regular products. Nationwide retailers are small grocery shops which arrange their working capital requirements of their own financing which require minimal intervention from the supply side of financing. Farmers on the other hand invest of their own in producing salt; some take informal loan from relatives and also micro credit from MFIs.</p>
Rice Husking Mills Cluster (Sherpur)	<p>Large rice processing units such as auto and semi-auto mills require large volume of working capital. The commercial banks are serving this market. During industry set-up purchase of expensive machineries require large fixed investment. Eventually, there is potential for leasing the machineries of auto and semi-auto rice mills during industry set-up. Majority of the small husking mills do not have bank loans. This is because bank loans require mortgage which they are not able to comply with. However, they need to maintain inventory stock. Introduction to warehouse receipt financing could solve their financing needs in this regard. Moreover, this could ensure inclusion of small enterprises in the financial system which could further reduce control of few large mills on the price fix-up. In regards to financing to other value chain actors, traders both in forward and backward linkage areas show similar financing habits and need financing for making stock. Generally, traders in both the end have access to working capital (generally CC loan) loan from commercial banks. Banks can explore for the un-met demand of these actors.</p>
Healthcare and Diagnostics	<p>Cost of expansion varies among the diagnostics center and clinics. Diagnostics centers require up gradation in expensive equipment for expansion. Expansions in clinics require extension of building premise and decoration. For extension of business premise requires substantial amount of advance payment to the land lord. Favorable policy interventions could make the units capable of accessing more/additional/larger bank loan and expand. Healthcare units purchase expensive equipment through EMI. However, there is scope of commercial banks for exploring for leasing and sale and lease back since purchasing equipment in cash require lesser price. However, it needs further exploring on differences of cost and benefits between supplier's credit and bank loans.</p>

Grow	
Cluster	Scope
Electrical and Electronics	<p>There is a need for technical training and technology resource centres in the clusters. This would facilitate skill development, promotion of imported and locally fabricated technologies and establishment of product standards. However, such facilities would require group based lending or equity financing from Bangladesh Bank on softer terms and interest rates. In this context, the scope to set up Special Purpose Entities (SPE) could be explored. Individually, the MSMEs in the clusters would benefit from single digit financing for procurement of improved machineries. It was revealed in the FGD that there are roughly 50 dice producers who cater to 600 electrical and electronic goods producers. These dice makers do not have sufficient machinery to produce the required</p>

	<p>number of moulds on time. The dice makers would prefer to have access to CNC machines which can increase their productivity. These enterprises could benefit from lease financing for purchase of capital machineries.</p> <p>The association BEMMA needs to undertake advocacy to facilitate resolution to issues like taxation policy which deters the MSMEs from transacting with Banks. To address the challenge related to MSMEs being unable to transact through Banks due to time constraint, BB could incentivize banks to invest on promoting smart phone based banking system for the MSMEs. It is unlikely that the MSMEs would shift fully from cash transaction to bank account based transaction. It is therefore essential to promote services that could facilitate MSMEs track their transaction history either electronically or manually. It would be necessary to ensure that such instruments are acceptable by financial institutions for debt financing. The liquidity crisis of the manufacturers could potentially be solved through overdraft loans. However, the MSMEs are not able to provide collateral for such loans. A potential alternative could be factoring of inventories the prospect for which needs to be explored.</p>
Embroidery	<p>The embroidery makers in the Khilket cluster face acute liquidity crisis because of credit based sales and long payment cycle maintained by the clients. These enterprises are not able to avail CC loan as they are not able to mortgage property. Short term seasonal loan of the MFIs could be marketed to solve this crisis. The prospect for receivables financing could also be explored. To enterprises could potentially benefit from single digit interest rate for machineries purchase. This could facilitate them to expand their business and increase productivity.</p>
Knitwear subcontracting	<p>The enterprises in the Knitwear Subcontracting Cluster in Konabari face working capital deficiency. The buyers clear the payment on a payment cycle of 60 to 90 days. The working capital requirement is primarily for worker's wages, utilities, rents. Since the raw materials are supplied by the buyers, they are not able to factor raw material for loans. This also reduces the attractiveness of these enterprises for bank financing. Thus the enterprises often resort to informal source (for instance local cooperatives) for financing for their working capital requirement of TK 10-15 lacs per month. Sweater factories have seasonality in the business. They produce during July to January time period. Thus they require more financing for working capital during the peak season. These are often financed from their own savings.</p>
Ready Made Garment Wholesale	<p>The wholesalers in the Narayanganj ready-made garment cluster face liquidity crisis due to longer payment cycle and credit sales. This leads to informal borrowing. Absence of such loans mean that the wholesalers are not able to expand their business. These enterprises are also not able to provide mortgage. To mitigate these challenges innovative short term investment financing mechanisms could be explored.</p>
Jamdani, Benarasi and Katan Cluster	<p>The enterprises in the Benarasi and Jamdani clusters require increased working capital during peak season such as wedding season, festival season, Bengali New Year etc. Findings from the FGD suggests that working capital need in the wedding season for a medium sized Jamdani weaver could be TK 10 to 15 lacs whereas, for a medium sized Benarasi weaver cum trader it could rise to as much as TK 50 lacs. For investing in working capital a medium sized Jamdani weaver requires TK 5 lacs to TK 10 lacs of loan whereas working capital loan requirement for a Benarasi weaver is TK 10 lacs to TK 20 lacs. Currently Jamdani weavers either borrow from informal sources or from MFIs with high cost or forgo opportunity for expansion.</p> <p>Though Benarasi weavers have access to bank very few (10% as reported in the FGD) have bank loans. The working capital loan requirement of the weavers can be served through SME loans or through MFI enterprise loans. Given the seasonal spike in loan requirement, the seasonal loans of the MFIs could be marketed to these enterprises. However, such loans are currently marketed primarily to the agricultural producers in rural areas. Financial literacy programmes in the cluster could help the enterprises determine their financing needs identify the right instrument for financing their working capital requirement. FGD with Benarasi weavers reveals that the number of designers has been declining rapidly in the cluster. This is attributed to lack of investment from the weavers (Collectively or individually) on design and product development. The increasing sales of imported Benarasi is also identified as a challenge leading to declining number of designers. A product design centre could be set up through a SPV in the cluster. This SPV could be owned by the association or a group of weavers and could run as a commercial entity. However, this would require grant from the government in addition to bank financing.</p>

Agor Ator Cluster (Maulavibazaar)	Agor Attor manufacturers mainly invest equity capital in leasing garden, meeting up factory operating cost. However, few of them also take working capital CC loans from commercial banks. SME Foundation has also extended refinancing schemes through BRAC Bank where BDT 50 million has been targeted to disburse out of which BDT 30 million has been disbursed. Agor Attor manufactures need capital requirements for taking lease of Agor garden. However, availability of garden is not enough for utilizing the factory capacity. There are acres of Government Khas land nearby. Policy level interventions is needed to give manufacturers access to the government Khas lands and initiate Agor gardening in cluster based approach. Banks can finance through term loans to the manufacturer for the gardening in government Khas lands. The Agor Attor clusters lack any quality testing facility within the cluster. A common facility for quality testing with improved testing lab could be set up where cluster members would share the facility. There could be potential for banks to finance the common facility.
Light engineering and metal works clusters	<p>The MSMEs in the clusters are not able to capitalise on the growing demand. According to the MSMEs in the clusters, their competitiveness could increase if they have single digit collateral free loans to invest on stocking ready to order products. This will help them to compete against cheap Chinese imported products.</p> <p>The need for common certifying facilities and common facilitation center for machineries rent and training is duly underscored in the policy documents prepared in light of facilitating competitiveness of the light engineering clusters. Engineering products produced by local enterprises are not certified for meeting international standards for quality assurance. Certain procedures, such as heat treatment, can improve the quality of inputs used and provide for better quality end products. It is not viable for the enterprises to invest on these capital machineries independently.</p> <p>The cluster needs to shift from dependency on internal financing instruments to external value chain financing instruments. To introduce factoring or work order finance, the MSMEs need to be supported to shift to formal work order based production system. This would require a cluster approach as all the MSMEs in the cluster needs to sign up to an agreement so that their internal competition does not drive the system back towards credit based system. Common facilitation centers could be established to support MSMEs have access to improved technologies like CNC machines, CAD machines and heat treatment facilities. In this context, special purpose vehicles (SPVs) could be set up in light of the experiences in India and European Union countries.</p>

Incubate	
Cluster	Scope
Plastics and Other Synthetics Cluster	MSEs that perform own-account manufacturing highly depend on wholesalers to market finished goods. In order to reduce the dependence on wholesalers and improve the functionality of own-account manufacturing enterprises, working capital loans need to be made available. The collateral terms of the loans need to be tailored to the operations of enterprises in this sector. That is, assets functional in the business need to be accepted as collateral rather than land only. Value chain financing is not viable in this sector due to weak market linkage between the producer and buyer. There is no dedicated buyer who can provide credit facility to the producer. Nevertheless, working capital loans can ease the constraints of the producers. As a cluster based approach, finance needs to be made available to improve the level of training of technicians of machinery. More trained manpower would reduce the down-time experienced by enterprises as maintenance and repair services will be more readily available. This would develop the productivity of the cluster as a whole. At present the clusters in this sector are sporadic and fail to capitalize on mutual benefits; a major reason being difficulty to access finance. Therefore, financing investments for the clusters, such as training of workforce or improving compliance standards, would improve competitive advantage and transparency.
Handloom (Tangail)	The handloom clusters observe seasonal spikes in sales. However, the production capacity of the enterprises is fixed and is directly related to the number of looms that they own. This means, if they are able to stock finished products for sales during the peak seasons, they would be able to earn more. Warehouse receipts can make them to stock finished products for sales during the peak seasons.
Leather making and leather goods	Tanneries in Hazaribagh are going through a relocation process currently. Since tanneries are the primary source of raw material, leather shoe manufacturers are facing

	<p>instability. Shoe manufacturers are not investing to expand at present. Since investing in expansion is concerned, manufacturers in this cluster currently are operating manually. Up gradation to a process of mechanization could increase productivity significantly. For example, semi-automatic hydraulic cutting machine, sewing, leather pasting machine, lasting machine etc. could make them able to keep pace with export market requirements. However, these manufacturers do not have the infrastructural requirement to adopt such mechanization. Moreover, these machines are expensive. A shared machinery facility could facilitate mechanization of the small enterprises.</p>
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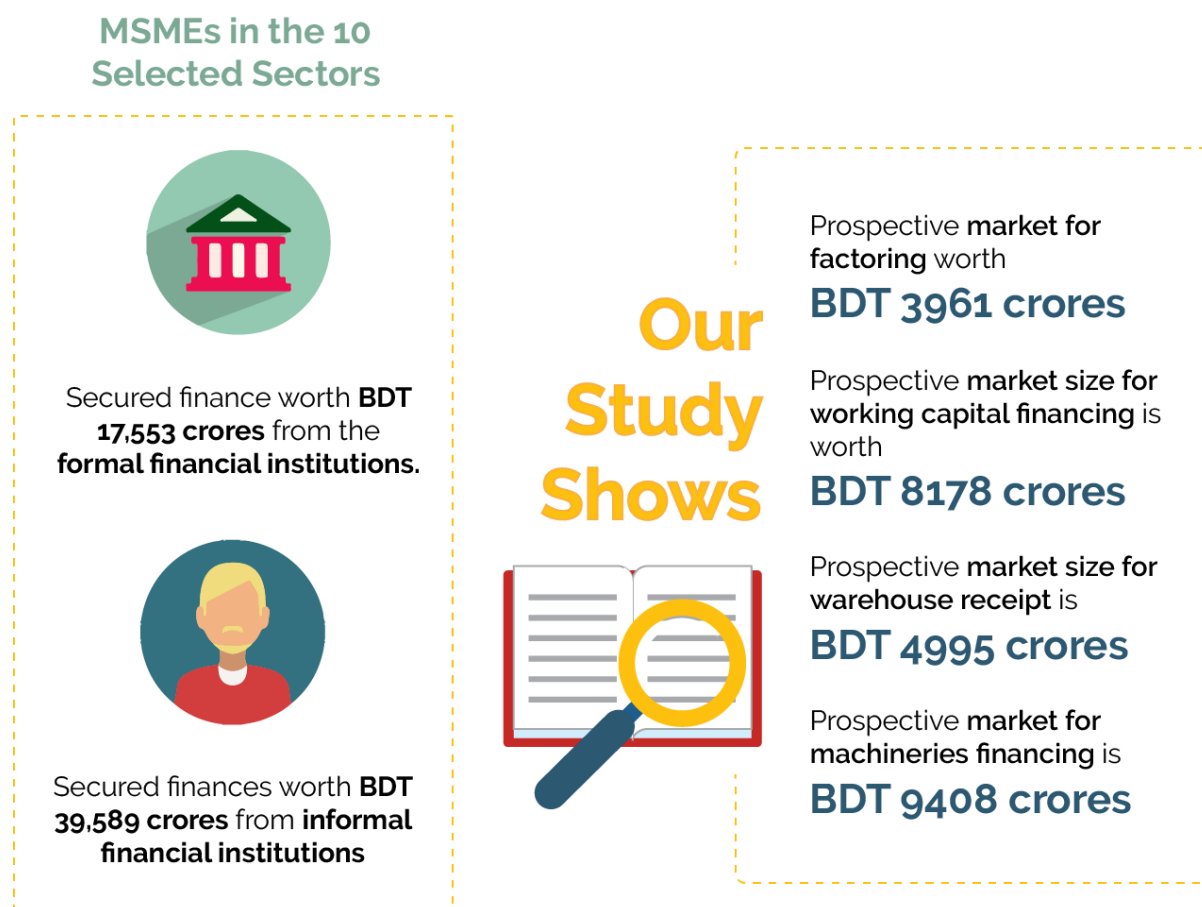
Observe	
Cluster	Scope
Fish processing (Shrimp Cluster)	Shrimp processing is a matured industry in regards to financing. There are specific subsidy requirements which are being handled by BB directly through the nationalized commercial banks. We do not observe unmet financing need in this cluster that could be met through value chain financing or cluster financing instruments.
Bamboo and cane clusters(Jessore and Pirojpur)	Handicrafts and bamboo clusters have limited production capacity. It is fully labour-intensive and requires artistic abilities. Thus the level of production is dependent on the number of workers engaged. As mentioned, it serves as a secondary source of income and supports poor families who usually have subsistence based primary income. Subsistence-based incomes, such as agriculture suffers from seasonal shocks from floods, droughts, etc. In these times household members focus more on primary income generating activity rather than handicrafts and bamboo product making. It can also be mentioned that the handicrafts producers are highly dependent on the local buyers to receive orders from out of their locality and to distribute their products. An improvement in the market channel for handicrafts can ensure a smoother flow of income for the poor households.
Jewelry cluster	Tanneries in Hazaribagh are going through a relocation process currently. Since tanneries are the primary source of raw material, leather shoe manufacturers are facing instability. Shoe manufacturers are not investing to expand at present. Since investing in expansion is concerned, manufacturers in this cluster currently are operating manually. Up gradation to a process of mechanization could increase productivity significantly. For example, semi-automatic hydraulic cutting machine, sewing, leather pasting machine, lasting machine etc. could make them able to keep pace with export market requirements. However, these manufacturers do not have the infrastructural requirement to adopt such mechanization. Moreover, these machines are expensive. A shared machinery facility could facilitate mechanization of the small enterprises.
Cotton Thread	Cotton thread producers take thread manufacturing as the secondary source of income. They are mainly wage earners. They require very low investment for purchasing the Charka and no investment in working capital. Moreover, this sector is a dying sector and identified as non-booster sector by the SME foundation. So there is low potential for financing in the cotton thread producers.

## 4. Financing the MSMEs- Review of the Reach and Capacity of the Financial Service Providers

The supply side comprises of the formal financial service providers and the informal financial service providers. The formal financial service providers include State Owned Banks, Private Commercial Banks, Non Bank Financial Institutions (NBFIs), Foreign Commercial Banks and the Micro Finance Institutions. The informal service providers include local money lenders (mohajons), suppliers and buyers in the value chain (in case the money lent is not under a formal contractual arrangement), friends and family members, local cooperatives and such. Extrapolation of our field data shows that the MSMEs in the clusters in the 10 selected sectors have secured finance worth BDT 17,553 crores from the formal financial institutions. In contrast they have secured finance worth BDT 39,589 crores from informal

financial institutions. Our findings show that there is a prospective market for factoring worth BDT 3961 crores. The prospective market size for working capital financing is worth TK 8178 crores. The prospective market size for warehouse receipt is BDT 4995 crores while the prospective market for machineries financing is BDT 9408 crores. In this section, we assessed the reach and capacity of the formal financial service providers in comparison to the informal financial service providers to understand the degree to which the MSME demand for financing services are being met. In this section, we analysed the degree to which the financial institutions are reaching out to the MSMEs to meet their demand and whether they have the capacity to serve the needs.

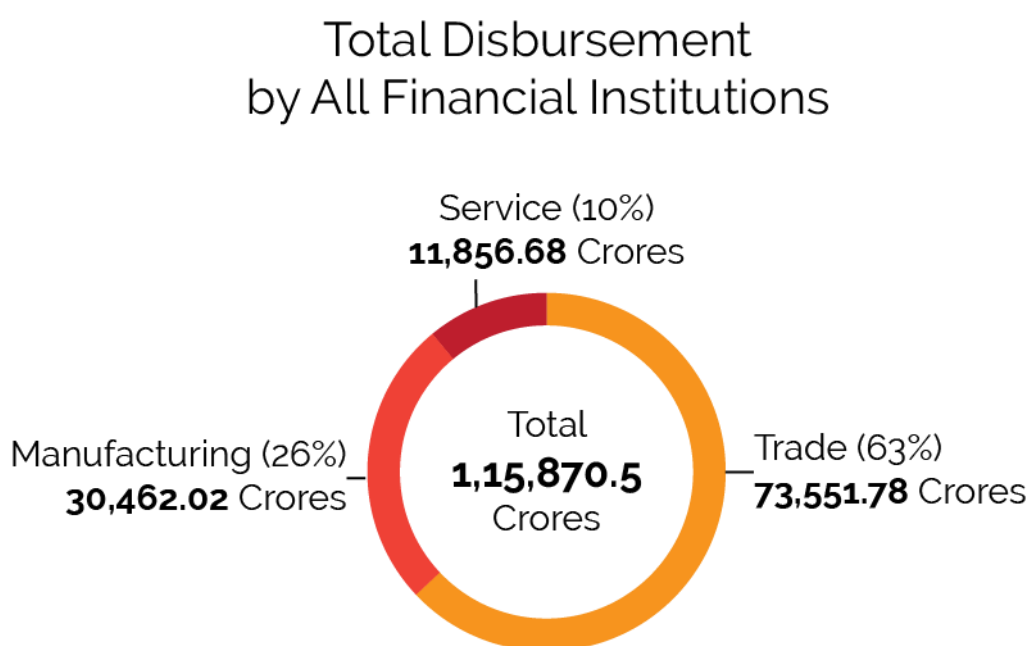
**Figure 23: The current and prospect market for financing in the selected clusters and value chains**



Bangladesh Bank offers refinancing facilities to banks and non-bank financial institutions to lend to MSMEs. The refinancing to banks is at the bank rate (currently 5%). Banks can lend to MSMEs at competitive rates. Women owned entrepreneurs are offered loans at a subsidised interest rate of 10% p.a. BB reports the refinancing scheme statistics by sectors as well on their official website. As of December 2015, BB disbursed BDT 1,15,879.5 Crore under the refinancing scheme. Of these, BDT 112,151 crore was disbursed through banks (112,151 Crore BDT) and BDT 3,720 crores was disbursed through NBFIs. Of the total disbursement, 63% was disbursed to trading sector enterprises (BDT 73,551.78 crores), 26% to manufacturing enterprises (BDT 30,462.02 crores) and 10% was distributed to service sector enterprises (BDT 11,856.68 crores). Of the total amount 45% was disbursed through private commercial banks and 41% through Islamic Banks. State Owned banks accounted for 9% of the total disbursement. NBFIs accounted for 3% of the total disbursement while foreign commercial banks and specialized banks accounted for respectively 1% of the total disbursement. 11%

of the refinancing disbursement through the banks was without collateral while 36% of the disbursement of the NBFIs was without collateral. Of the total disbursement, 12% was without collateral. The data shows that private commercial banks play a dominant role in MSME financing. However, NBFIs play a more significant role in reaching out enterprises without collateral. As we presented, the manufacturing enterprises in the 60 clusters in the 10 selected sectors that we studied availed finance worth BDT 39,589 crores from informal providers. This would manifold if we account for the financing availed from the informal sources by the manufacturers in all the 170 clusters listed by SMEF. The data shows that the BB refinancing scheme is not serving a large part of the market since the finance is being disbursed to trade and service enterprises beyond the clusters and the value chains since these enterprises are more ready for finance and are less risky for investment.

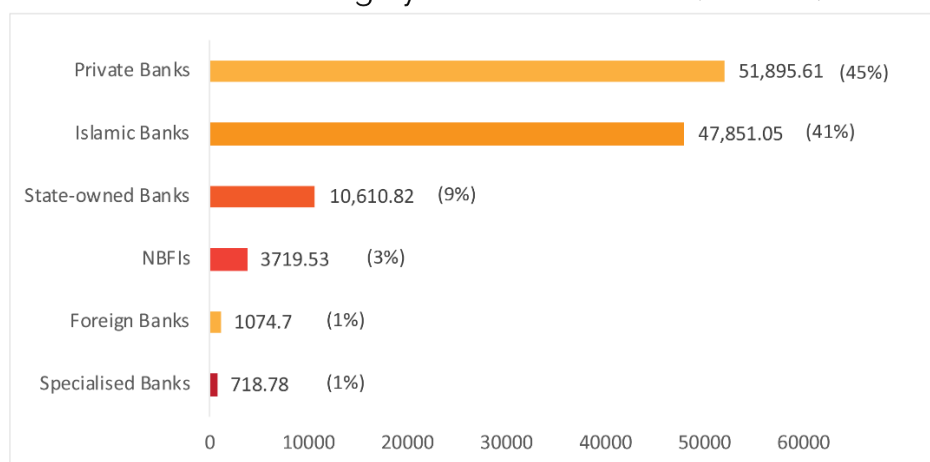
**Figure 24: Nationwide disbursement of the BB refinancing scheme for the MSMEs**  
(As of December 2015 (source BB))



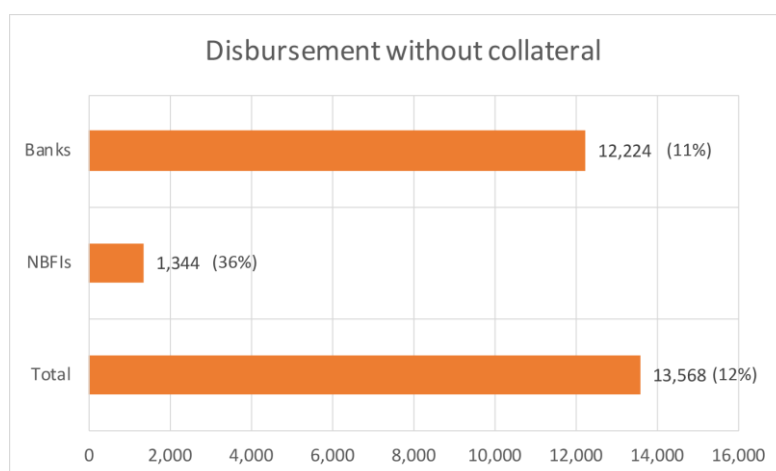
**Figure 25: Nationwide disbursement of the BB refinancing scheme for the MSMEs- Segregated by type of Financial Institution**

(As of December 2015 (source BB))

SME Refinancing by financial institutes (In Crore)



**Figure 26: Nationwide disbursement without collateral under the BB refinancing scheme**



SME Foundation have identified clusters across the country and offers banks pre-financing at a subsidized interest rate of 4% p.a. to reach out to these clusters and provide funding at subsidized interest rate of 9% p.a. The banks receive funds in advance for clusters that the banks agree to lend to. Banks have mentioned that there is very little incentive for them as the clusters comprise of too few MSEs that are also too small to develop a programmatic approach to lending. The cost of loan supervision is also very high because the loan volume is low. As we proposed earlier in this report, this problem could be solved if the definition of clusters was

broadened to incorporate all the enterprises in the value chain of the specific product that the value chain deals with and if the SMEF funding was channelled towards attracting the backward and forward market linkage actors within the clusters. Review of the disbursement of the SMEF Credit Wholesale Programme shows that the fund is being disbursed in small value to clusters through specific financial institutes. Discussion during the FGDs suggested that the fund does not reach out to most of the MSMEs in the clusters and does not support growth of the overall cluster thereby limiting the development impact of the fund.

**Figure 27: Disbursement status of the SMEF Credit Wholesale Programme (Source: SMEF)**



Based on the findings from the field interviews with the stakeholders we can ascertain that MSME financing is a key agenda for the formal financial institutions. However, their capacity to serve the MSMEs vary.

### State Owned Banks

Operating within the purview of the BB policy. Preferred by MSMEs operating in the export market. These banks are unlikely to invest on developing the MSME capacity for financial readiness if not directed or mandated by BB

### Private Commercial Banks

Being increasingly competitive with expanding network and diversified products. The competition could drive them further to invest on building MSME capacity for financial readiness. However, they would require state support to sustain the investment.

### NBFIs

More suitable for certain type of products and clusters (for instance those requiring capital machineries). However they have limited national outreach. They are more likely to deepen their engagement with clusters that they are currently serving.

### MFIs

Are more suitable for MSME development through cluster and value chain based financing approach. But they are yet to take up national level intervention for investment on collective development needs. Focus remains individual enterprises.

### Foreign Commercial Banks

Unlikely to invest on capacity development of the micro enterprises given the cost of business and their global strategy for risk mitigation. They are more likely to deepen their engagement through MFIs

## Snapshot: Comparative Review of the Reach and Capacity of the Formal Financial Service Providers

Product Suitability	
<p><b>State Owned Banks</b></p> <p>These banks do not have a cluster and value chain based lending approach although they are likely to have significant financing in clusters across Bangladesh as a result of their extensive reach. These banks have SME desks as required by Bangladesh Bank. The state owned banks are the preferred destination of the MSMEs that operate in the export market since the government subsidies are provided through the state owned banks.</p>	<p><b>Private Commercial Banks</b></p> <p>The banking sector is still largely dependent on mortgage of property to secure loans. This is because, in some cases the bank's management is very risk averse while in other cases this is a requirement mandated by the board of directors. Banks that have approached MSME finance in a structured manner have been able to slowly increase their appetite for collateral free loans while developing processes and systems to manage these loans. Among the majority of the banks interviewed, it was clear that they are not engaged in cluster based financing. They seek out businesses to lend to and then as required by Bangladesh Bank categorise them into clusters wherever possible.</p> <p>There is no standard definition of cluster and cluster based financing. Bangladesh Bank suggested to banks that they develop a cluster development policy. Banks that have some awareness of cluster and reporting financing of various clusters to Bangladesh Bank have been using their own customised definition. Most banks have been defining clusters as per their own understanding and advantage. There are very few banks that have been looking at clusters as potential borrowers. Banks lend to business that are able to meet the bank's requirements with respect to documentation and ability of repay loans.</p>
<p><b>Islamic Banks</b></p> <p>Islamic banks are commercial banks that are Islamic sharia (Islamic law) compliant. These banking services are highly sought after in Bangladesh because many customers prefer to be in compliance with religious practices such as the avoidance of interest. Islamic banking is characterised by the sharing of profit and loss and the prohibition of payment and collection of interest (a fixed return)<sup>13</sup>. However, Islamic banks in Bangladesh mainly secure their investments with mortgage of property. Islami Bank Bangladesh has the single largest SME loan portfolio among all the banks comprising approximately 27% of all SME loans. Similarly, Islami Banks' microfinance loans portfolio under their Rural Development Services makes them 4<sup>th</sup> largest microfinance lender in the country after Grameen Bank, BRAC and ASA. The microfinance loans are collateral free.</p>	<p><b>Foreign Commercial Banks</b></p> <p>These banks focus heavily on corporate clients and retail loans to salaried individuals. There is also a major push to offer non-funded services such as L/C and guarantees to facilitate trade. This is not to say that these banks do not lend in the SME space but rather focus effort on providing financial services to medium enterprise. In the context of MSE financial services, foreign commercial banks are not well suited due to the lack of outreach in terms of branches.</p>
<p><b>NBFIs</b></p> <p>Lease financing allows MSMEs to finance their required assets without the need for mortgage of property because the asset is owned by the NBFi until the title is transferred at the end of the lease period. Leasing allows MSMEs to finance 100% of the equipment cost although in practice the MSMEs are</p>	<p><b>MFIs</b></p> <p>From the perspective of cluster development, MFIs have a very important role to play as they already have deep engagements within the clusters and have the credibility to get the institutions within a cluster to come together and collaboratively mobilize resources for building bankability. This positioning comes from the</p>

<sup>13</sup> <http://www.investopedia.com/terms/i/islamicbanking.asp>

<p>required to pay part of the cost of the equipment up-front.</p> <p>Similarly factoring allows MSMEs to get mortgage free loans because the buyer commits to pay the NBFi the amount of the invoice instead of the MSME that supplied the goods or services. Once the payment is received by the NBFi, the amount owed by the MSME (inclusive of interest) is deducted and the remainder paid to the MSME by the NBFi.</p> <p>NBFIs are able to access Bangladesh Bank's refinance scheme for lending to MSMEs using all of the above mentioned financial products.</p>	<p>fact that MFIs have an existing reach that goes down to the grassroots level. The said structure gives them very close access to clients on whom they are able to impart necessary training, build savings habit and provide technical assistance on building up micro businesses.</p> <p>Banks and NBFIs collectively have very low penetration in the MSE market as it is still quite easy for them to find medium clients who borrow large amounts making the deal more efficient in terms of returns on effort. This market scenario provides very little incentives for banks and NBFIs to actually invest in cluster development.</p> <p>As such when it comes to cluster development and cluster finance, MFIs are clearly positioned ideally for creating the greatest impact in bringing together the units in a cluster and promoting collective and inclusive development of clusters.</p>
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Institutional Capacity	
<p><b>State Owned Banks</b></p> <p>The banks tend to be bureaucratic in addition to being large and as such require more time to comply with Bangladesh Bank requests for new types of information. These banks, for the most part, are not yet tracking their financing in clusters and value-chains.</p>	<p><b>Private Commercial Banks</b></p> <p>The introduction of agent banking in Bangladesh has created the ability of banks willing to finance in rural areas. One additional step forward would be for the agents to help the banks identify clusters in their areas and to help these clusters develop their capabilities so that banks would be willing to lend to them. Presently there are some banks that are slowly expanding their reach through agent banking and some early market leaders are emerging. Although the focus is mainly in the mobilisation of deposits, the agent outlets will also be sourcing potential borrowers.</p> <p>Whether it is the bank staff at the branches across the country or the staff at agent outlets, the grassroots banking system needs to be proactive in addressing the needs of the businesses. However, this is missing presently due to a lack of incentive for the bankers to go out and gather information so that they will be able to target potential business clusters and value chain players. In most cases, the banks' leaders are not creating sufficient interest or challenging bank staff to reach out to business that either have the potential to grow or create a group of businesses that work together to achieve synergies that will enable the banks to grow their portfolio as these businesses grow.</p> <p>There are not many sources of information with respect to cluster and value chains. The banks are also not investing in gathering market intelligence on these because they consider the market too small. However, when clusters are identified, they are at least interested in exploring whether these businesses meet their lending criteria. Banks do not rely on external organisations to help them develop financial products/instruments as this involves confidential information vis-à-vis their credit and operational policies.</p>
<p><b>Islamic Bank</b></p> <p>Islamic banks do not and cannot participate in Bangladesh Bank's refinancing schemes because</p>	<p><b>Foreign Commercial Banks</b></p> <p>The foreign commercial banks have internal risk rating systems that are used to manage portfolio risk across</p>

<p>they are not sharia compliant, i.e. Bangladesh Bank charges interest on the funds. Although penal interest is not allowed in Islamic banking, the banks charge this to ensure that the client make their payments on time. Islamic banks do not take the penal interest into their income but rather place them in a fund that is used for socially beneficial projects such as hospitals and medical treatments for the poor, etc.</p>	<p>the countries they operate in. This is more pronounced in the large, diversified international banks, and in particular those that are based in developed countries. In order to allow for risk comparison, a country risk is used in addition to the client risk. According to the Organisation for Economic Co-operation and Development (OECD) Bangladesh country risk rating is five (5)<sup>14</sup>. As a point of reference, India is rated three (3) while Pakistan is rated seven (7). The lower the number, the better quality is the risk. Therefore, if a blue chip corporate client in Bangladesh is rated one (1) in-country (the best possible), the international banks' internal rating will place it at six (6). Depending on the risk appetite of the bank, the maximum internal risk rating would be set to mark the threshold beyond which the bank could not lend. Therefore, it is likely that the MSE businesses could not be considered as per the bank's policy.</p> <p>However, these banks do lend to the MSEs through intermediary organizations such as microfinance institutions. They take the risk on the MFIs rather than on individual MSEs. In cases where the internal risk rating is too high, the bank may wholly or partially secure the loans to the MFIs with cash deposits.</p>
<p><b>NBFIs</b></p> <p>Non-Bank Financial Institutions (NBFIs) cannot issue cheques, pay orders or demand drafts and cannot receive demand deposits (current and savings accounts) or be involved in foreign exchange financing. These organisations offer syndicated financing, bridge financing, lease financing, securitization instruments, private placement of equity, etc.<sup>15</sup></p> <p>NBFIs cannot offer overdraft/cash credit (CC) loan facilities and therefore have to focus on instalment loans, lease finance as their main source of revenue. Some NBFIs are engaged in factoring or products of similar characteristics.</p> <p>NBFIs generally have greater risk appetite although their interest rates are higher than banks. However, in most cases the NBFIs do not have a very big branch network and therefore cannot reach out across the country.</p> <p>Similar to banks, NBFIs lend to MSMEs and some of these businesses may be part of a cluster. However, most NBFIs are not engaged in cluster based financing. SME Foundation works with NBFIs as well as banks under the same conditions.</p> <p>NBFIs often work with associations to identify potential customers. There have been some good experiences as a result of support provided by the association in ensuring that the members who have taken loans pay back the loans on time. There have been some bad experiences as well where the association became enraged because the NBF found that the members</p>	<p><b>MFIs</b></p> <p>The success in microfinance has not helped the beneficiaries to leverage their success to secure financial services from the traditional banking sector due to documentation, cultural, religious and literacy issues. These individuals continue to rely on informal delivery systems for their financial services. The beneficiaries include female heads of households, self-employed individuals or small businesses, pensioners, displaced people, retrenched workers and small/marginal farmers and other informal sector participants<sup>16</sup>. The MFI Credit Information Bureau (CIB) has been in the planning for many years but has not yet been set up.</p> <p>Among more proactive and MSME focused banks, we sometimes see cases where bank and MFIs concurrently lend to the same client. However, this is not commonplace yet. If this trend increases as a result of the lower interest rates that the banks charge, there may be a disincentive for MFIs to work extensively on cluster development and a separate entity mandated towards cluster development seems more appropriate.</p> <p>The MRA has relaxed its regulations to allow MFIs to have up to 50% of their portfolio in micro enterprises and also for micro enterprises to borrow from more than one MFI, thereby increasing the total loan amount available to Micro Enterprises. On the flip side it also means that MFIs have become more dependent on the client's integrity in matters of loan disclosure as the need to have a micro finance credit information bureau remains unaddressed.</p>

<sup>14</sup> <http://www.oecd.org/trade/xcred/cre-crc-current-english.pdf>

<sup>15</sup> <https://www.bb.org.bd/finansys/bankfi.php>

<sup>16</sup> [http://www.plancomm.gov.bd/wp-content/uploads/2015/02/1\\_Improving-Access-of-the-Poor-to-Financial-Services.pdf](http://www.plancomm.gov.bd/wp-content/uploads/2015/02/1_Improving-Access-of-the-Poor-to-Financial-Services.pdf)

recommended by the association could not meet the NBFIs' lending criteria	<p>The MFIs have adapted to this situation by increasing vigilance and supervision of the clients and developing very focused need based cash flow aligned financial solutions which were found to be very popular as a means of accessing finance.</p> <p>A more systemic solution in the form of a micro finance CIB would help MFIs reduce effort wasted in monitoring and close supervision and instead, focus more on their core activity of micro enterprise lending.</p>
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## Snapshot: Embracing Development as the Core Agenda for MSME Financial Inclusion: The Experience of the Palli Karma Shahayak Foundation (PKSF) and the Role of Micro Credit Regulatory Agency (MRA) in MSME Financing

PKSF is the microcredit wholesale lending agency in Bangladesh. As of 30 April, 2017, PKSF had 277 partner organizations with a total membership of 12.79 million. Women members constitute 90.92% (about 11.63 million) of the total members. As of 30 April, 2017 the POs accounted for 9.90 million borrowers. The total disbursement of loan in the financial year 2016-2017 was BDT 297.39 billion. This was about 26.25% higher than the previous financial year. According to PKSF, apart from their flexible microcredit products (which range from seasonal loan to enterprise loan and emergency loans at variable interest rates and loan period) a key to their success has been their deep engagement in providing technical, extension and marketing support to their borrowers/ members through their partner NGOs. PKSF embraced this approach primarily through two projects- the FEDEC project which is jointly funded by PKSF and IFAD and the DFID funded PRIME (under the broader PROSPER programme). The success of these

initiatives meant that the POs begin to integrate the provision of marketing, technical and extension services as embedded to its service provision for microcredit. Better business health of the micro enterprises meant that they are more credit worthy. While in PRIME PKSF focused on supporting MEs with a package of financial (variable credit programmes) and non-financial services (marketing, extension, training supports on selective IGAs), the FEDEC project and now the PACE project are being implemented with the goal to solve challenges that impede the growth prospect of the promising value chains where the MEs are currently engaged or could potentially engage. Innovision undertook a pathway analysis of the PROSPER programme in 2016. The following excerpt from the report highlights how investment on marketing, extension and training support to the micro-enterprises result double bottomlines – growth of microenterprises and growth of microcredit organization's lending market:

### Case: The interconnectedness between marketing, training and extension support to micro-enterprises and its impact on financial markets: The Experience of PRIME

Programmed Initiative for Monga Eradication (PRIME) was a component of the DFID funded Promoting Financial Service for Poverty Reduction (PROSPER) programme. The PRIME interventions included a package of financial and non-financial services that could sustainably reach the extreme poor households with flexible financial services and help them graduate out of poverty. The programme was implemented over the period 2006-2016. Innovision Consulting undertook a pathway analysis of the programme in 2016. The results suggested that the PRIME interventions facilitated targeted beneficiaries to achieve higher household income and increase their asset base. Furthermore, the households were more resilient to natural and economic shocks. This meant that the households were able to use financial services more judiciously on different income generating activities as the households graduated out of poverty. Furthermore, the increase in wealth of the households resulted improved financial performance of the Partner Organizations (POs) under PRIME. The Project Completion Report (2016) revealed that 55% of PO branches under PRIME had an Operational Self Sufficiency (OSS) of at least 100% (i.e covered all their costs). A key factor that contributed to the

improvement in OSS was the fact that significant percentage of PRIME members graduated to normal PKSf micro-finance terms with higher interest rates than ultra-poor loans. Of the value of loans disbursed in the second half of 2015, 50% was flexible micro-finance on special ultra-poor terms, 2% were emergency loans and 47% were on normal micro-credit terms.

Our analysis showed that as the households graduate, they transfer to regular microfinance terms at higher interest rates. This increases the profitability and generates surplus from the interests which the POs could invest on retaining the capacities required to sustain the PRIME packages and service delivery mechanism to target the ultra-poor. A critical learning from PRIME was that to make the financial services more inclusive, the financial organizations need to do more than just disbursing credit. The borrowers need support to identify market opportunities, develop skills to produce their products or start a vocation, market their produce to the right target market and make informed decisions on investment to diversify their sources of income. The POs extended these supports and were able to generate enough income that could help them to retain the staffs and organizational structure that could facilitate extending these supports to the borrowers.

### Case: PKSf intervenes in value chains and clusters to support micro enterprises make better use of credit

The Finance for Enterprise Development and Employment Creation (FEDEC) project (2008-2014) co-funded by the International Fund for Agricultural Development (IFAD) and PKSf and implemented by PKSf, adopted value chain development as a core strategy for enterprise development and employment creation. Under the project PKSf intervened in 44 value chains in Bangladesh. The value chains ranged from floriculture, to cattle fattening, crab culture, prawn culture in flood plain areas, sea weeds culture, hygienic dry fish production and such. The interventions included a range of market linkage support, product quality improvement training. The learning from FEDEC was used to launch the Promoting Agricultural Commercialization and Enterprises (PACE) project. A key element of PACE is investment on infrastructural and business development services which are essential for the growth and competitiveness of the value chains in which PKSf is providing microfinance to microenterprises. For instance, in the crab culture value chain the project invested on developing a hatchery which reduces the dependence of the beneficiaries on natural sources. The project is also intervening on novel and innovative approaches which includes branding local products such that there is a quality seal and image that could expand the market base for the product. Examples cited includes Kushtia Beef with no hormones or Mumtaj Buffalo from Char Mumtaj.

The experience of PKSf shows that MEs are better able to access and use financial products if they have the capacity to solve their operational or market challenges. Financial institutions do not have the mandate to assume such development roles. Beyond the microfinance regime, SMEF potentially could be the agency that engages in facilitating cluster and value chain development that in turn supports Financial Institutions expand their outreach within the micro and small enterprises. However, unlike PKSf and its POs which have direct financial incentives to invest on cluster and value chain development, SMEF does not have a direct incentive. Furthermore, unlike PKSf that has a direct influence on the POs, SMEF does not have an authority on the financial institutions. BB and SMEF thus have to work jointly to embrace cluster and value chain development as instruments to facilitate demand for and supply of financial services for the MSMEs. In this arrangement, SMEF could work on defining the scope for finance and investment in the value chains and clusters while BB could influence financial institutions to invest on specific development needs of the value chains and clusters. This would require that the SMEF credit wholesale programme and BB refinancing programmes are all aligned to achieve development goal rather than disbursement targets. We discussed this further in the constraints and recommendations section of this report.

The role of MRA is significant in the discussion of the engagement of MFIs in facilitating finance for micro enterprises. MRA was created to assimilate all the Non-Government Microfinance Institutions (NGO-MFIs) under one regulatory structure. Under "Microcredit Regulatory Authority Act 2006, the government established this organisation to ensure the transparency and accountability of microcredit

activities of the NGO-MFIs in the country. Another intension of its establishment is to nurture growth of this sector. MRA has its own goals and sets of responsibilities. One of the goals is to formulate and implement the policies to establish and maintain good governance in the financial systems of MFIs. To carry out research, provide policy guidance and circulate the findings are some other goals of this organisation. Moreover, MRA has been assisting Government to develop inclusive financial system. Capacity building of the MFIs on efficient management is another target of this organisation. MRA has been working under the act and ensuring its three specific responsibilities; they are, licensing the MFIs, supervising them so that they can ensure licensing requirements and enforcement of sanctions if any MFI unsuccessful to carry out licensing requirements. As of annual report 2015, 697 MFIs and 15,609 branches have been certified by MRA. Total disbursement of MRA authorised micro credit organisation is BDT 634,000 Cr, disbursement through Grameen bank was 13890 Cr BDT.<sup>17</sup>

The role of MRA is significant for instituting Cluster and Value chain financing in Bangladesh since the MFIs are one of the important sources (25% for Manufactures/producers of the selected clusters) of finance for the MSMEs. Especially micro sized enterprises are basically dependent on MFIs. 35% of micro sized manufactures and 34.1% of the other actors of value chain avail loan from MFIs. As of MRA 2015 database, only 4 MFIs are providing loan of BDT 5lac or more which is only 0.06% of the total registered MFIs. 3.2% of the MFIs disbursement was between BDT 1 lac to 5 lacs, 20.2% of the MFIs distributed between BDT 10,000 to 1lac and the rest 76% MFIs disbursed less than 10,000 BDT. The MRA has relaxed its regulations to allow MFIs to have loan up to 50% of their portfolio in micro enterprises and also for micro enterprises to borrow from more than one MFI, thereby increasing the total loan amount available to Micro Enterprises.

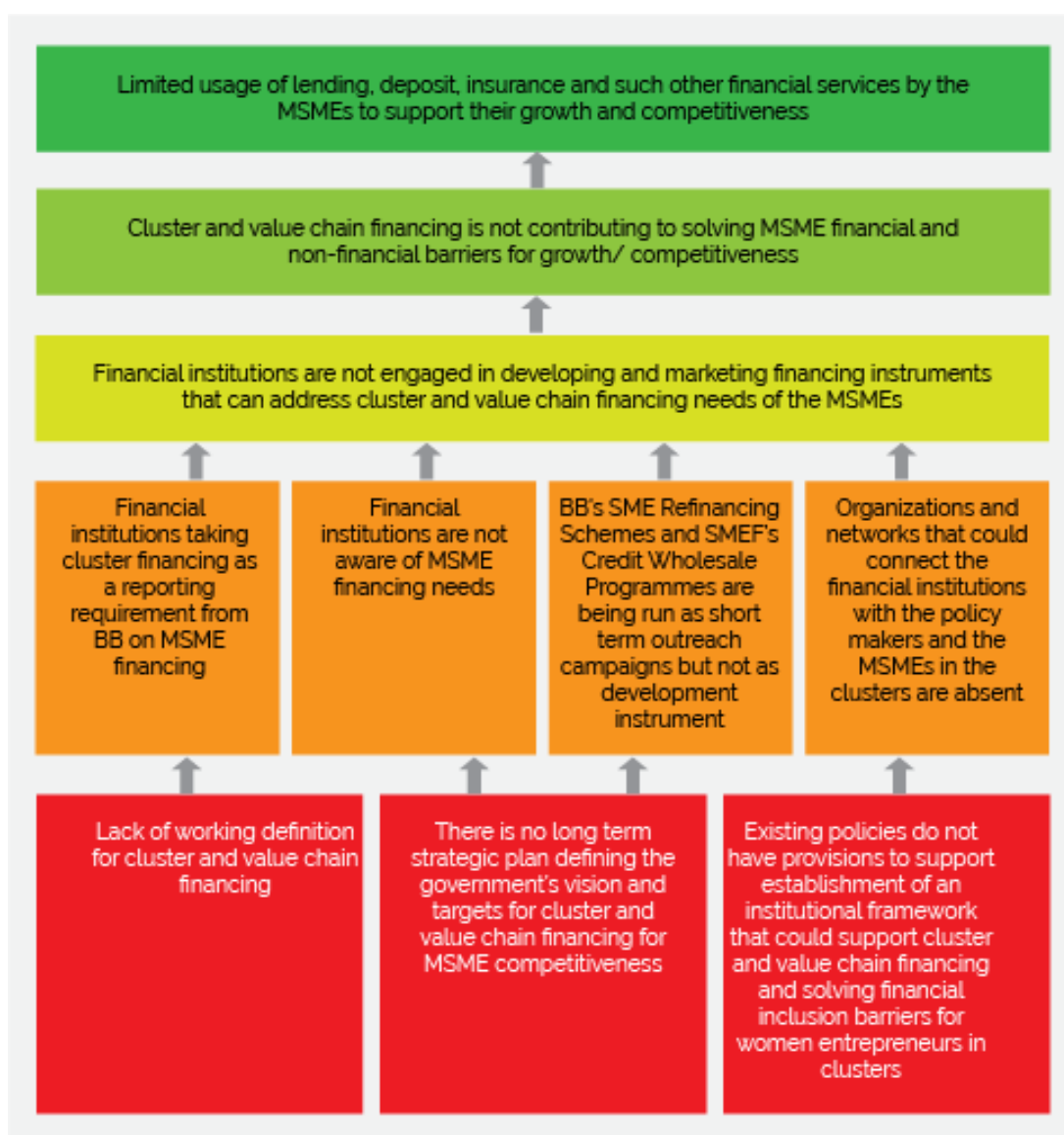
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<sup>17</sup> MRA Annual report 2015

## 5. Analysis of the Systemic Constraints

For the MSMEs to grow, they need to be able to use the financial instruments to support their competitiveness. Our study shows that the majority of MSMEs are using financial services. But these are not essentially contributing to their growth/competitiveness as the available instruments are not tailored to solve the MSME financial needs and challenges. Our study suggest that the existing policy is supply driven whereby the performance is measured by outreach and value of total lending. The policies are thus designed to ensure that the government's financial stimulus are reaching out to wider number of sectors and clusters at the cost of deeper impact per enterprise per cluster. The existing policies neither capacitate nor dictate financial institutions to be proactive. The institutions are mostly taking reactionary measures for cluster and value chain financing. As such the promise remains unexplored.

**Figure 28: Systemic Constraints for Cluster and Value Chain Financing**



We can define the challenges in cluster and value chain financing under four categories of systemic dysfunctions- (i) regulatory (ii) technical (knowledge, skills and information) (iii) institutional (iv) socio-economic.

## 5.1 Regulatory Barriers

MSME development and MSME financing is a major development agenda in Bangladesh. The need for MSME financing and the strategic actions that are needed are all well identified in the SME Credit Policies and Programmes of Bangladesh. SMEF, BSCIC has their own policies with regards to MSME financing and development. The scope for MSME financing and financial inclusion is also underscored in the 7<sup>th</sup> 5 year plan. A national financial inclusion strategy is now being developed.

From our review, we could not ascertain whether there is one policy document that is being used as the guiding document for MSME financing by all other agencies. The challenge is well reflected on the case that MSMEs are being defined differently by different agencies and there is no universally accepted definition of clusters and value chains in Bangladesh.

Secondly, we do not have a detailed policy on cluster and value chain financing which explains why and how these should be adopted for MSME financing. Cluster and value chain financing is loosely defined to induce regular MSME financing schemes to specific clusters and value chains. The development agenda of cluster and value chain financing is not duly underscored. As such, the potential of cluster and value chain financing in solving the systemic barriers for growth of MSME clusters and value chains is not realized. Though the BB policy identifies some key policies with regards to diagnostics and mapping of clusters and setting up cluster development committees, we are yet to see these in actions.

Thirdly, the incentive schemes are loosely implemented without any long term strategic direction on sight. The schemes are accessed by limited number of MSMEs in a cluster for a limited period of time after which the financing scheme is withdrawn

from the cluster and allocated to the MSMEs in a separate cluster. Thus the MSMEs availing single digit interest loans are again exposed to double digit interest loans in a short period of time. This short term push is not enough to trigger systemic change across a cluster or a value chain. On the contrary, if such schemes were used to attract investment of the private sector on unmet development needs of the cluster or a value chain (for instance training center, common facilitation center, warehouse facility and such), the impact could have wider impact as the benefit would have reached out to large number of enterprises in the cluster.

Fourthly, the policies do not take into consideration that the financing needs of MSMEs vary with respect to their cluster and to their position in the value chains. Further to that, the policies are blind to MSMEs in the backward and forward market linkage of the value chains and are designed with the assumption that the MSMEs are only concentrated in the production function of a value chain. This myopic focus means that finance is targeted towards enterprises that might have lesser benefit from financing and lesser impact on the overall growth and competitiveness of the clusters and the value chains.

## 5.2 Technical Barriers

The technical barriers are related to knowledge, skills and information of three groups of stakeholders- the policy makers, the financial institutions and the MSMEs across all value chain functions. The policy stakeholders and financial institutions need to have better understanding of the functioning of the clusters and the value chains, their individual challenges and market prospects. The SME Foundation Study on Clusters in Bangladesh does provide some details albeit not comprehensive. But the SME Foundation report provides information only for the MSMEs in the production function. We do not get idea on the challenges and opportunities across the value chain. We also do not get to know the development need and challenges to competitiveness in each of the clusters and the value chains. On the supply side, the MSMEs need to have better understanding of their financing needs

and requirement. They need to be able to ascertain the long term benefit of bank transactions and formal financing on their business growth as opposed to cash based transactions and financing through supplier's credit and informal systems.

## 5.3 Institutional Barriers

The institutional barriers include lack of coordination and synergy in policies and interventions of the agencies that are engaged in MSME financing in Bangladesh. Given the complexity in the structure and organization of the MSME sectors in Bangladesh, it is unlikely that there would be only one agency working on MSME development. It is nevertheless essential that the interventions of the agencies are synergized to ensure long term sustainable gains for MSMEs in Bangladesh. However, coordination units that do not have executive decision making power are also not effective. There thus need to be an agency that has the core mandate for MSME development while the other agencies work as wings or support units for the core agency.

A critical institutional barrier is the competitive space between the MFIs and the banks and non bank financial institutions in Bangladesh. The MFIs can have 50% of their loan portfolio targeted to enterprises. Their loan ceiling is BDT 10,00,000 per enterprise with the exception of BRAC, Sajeda Foundation which are providing enterprise loans up to BDT 25,00,000. Loans beyond BDT 10,00,000 are to be treated under BB policy. MFIs currently allow non-lateral entry. Which means enterprises which previously did not have loan history with an MFI can also borrow. Currently, 25% of the MFI portfolio comprises of enterprise loan against the cap of 50%. Our findings show that MFIs are yet not a major source of finance for the MSMEs in the sectors and clusters that were studied. However, the interviews with the MFIs reveal their interest to penetrate the domain of enterprise financing. In comparison to the banking and non-banking financial institutions, the MFIs are more able to play the development

role due to their deeply rooted and widely spread network of field officers. Given this, the prospect of value chain and cluster financing to certain degree would depend on defining the competitive space of the MFIs and the financial institutions and the policies that define the scope.

The trade associations are yet to play a strategic development role for their respective clusters and value chains. Most clusters do not have functional associations. The associations that are active do not have direct and sustained engagement on financial advisory support for their members. There is no formal agency in Bangladesh, either public or private, that has dedicated engagement in cluster development. In absence of such, the interventions and efforts have mostly remained short term and driven by availability of donor funding.

## 5.4 Socio Economic Barriers

The socio economic barriers include how the MSMEs perceive external debt financing for their business growth and how they operate their businesses. As we have explained, large number of MSMEs in Bangladesh prefer cash based transaction to avoid Tax and VAT. Furthermore, the orders are mostly received informally without any work order. These affect their credit worthiness. The financing requirement are often short term, triggered by seasonal spikes in sales, liquidity crisis and such. Financing practices are driven by the need to meet short term cash crisis rather than long term expansion plan. Women entrepreneurs prefer to trade from home and often apply for registration after several years in business operation when there is a need for financing. Such behaviors.

To understand the details of the systemic barriers explained in this section it is recommended that the readers review ANNEX 2.

## 6. Roadmap for Cluster and Value Chain Financing

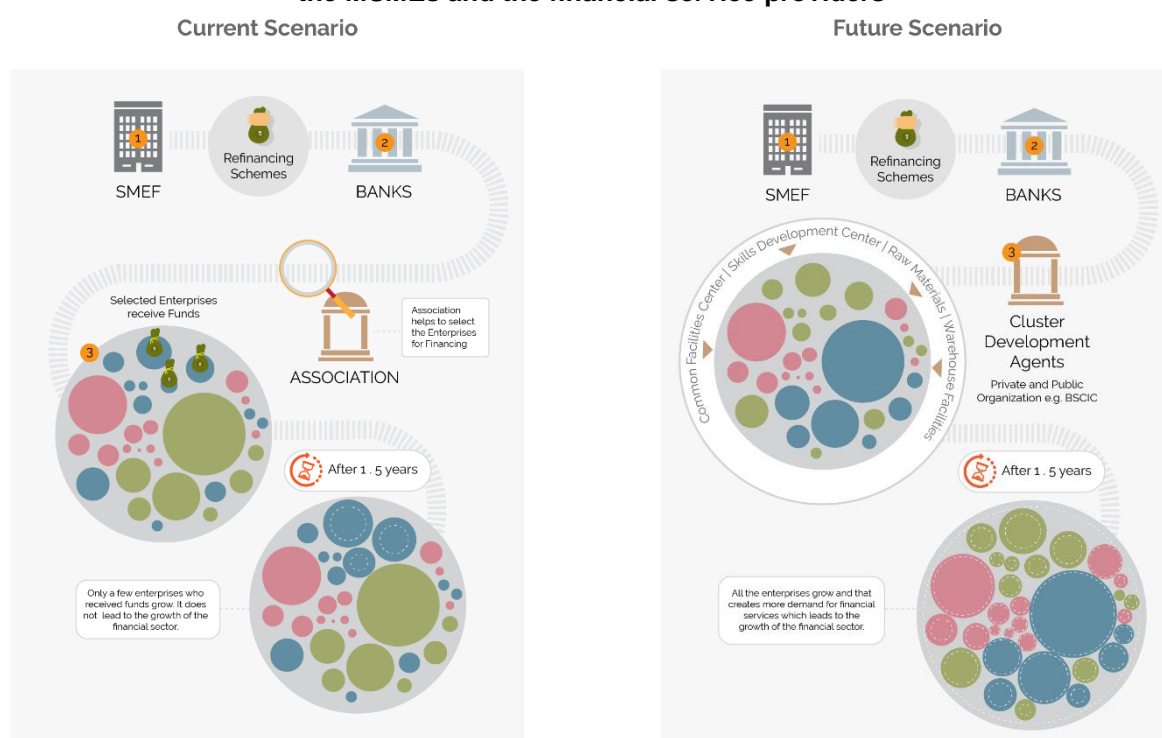
In light of the challenges underscored, we propose the following strategic action plan for cluster and value chain financing in Bangladesh.

**Define the central agency for coordination and management of MSME development in Bangladesh.** This would help to improve efficiency in the interventions and leverage on the capacity and competency of individual agencies. Furthermore, this would reduce complexity in policy development and

suited to lead the refinancing instruments and can coordinate with SMEF for the decisions on allocations to specific clusters and value chains. BSCIC is expected to have its own specialized roles within BSCIC territories. Beyond BSCIC, SMEF is expected to assume the role of the key anchor agency.

**Have a central definition of the scope and the development agenda to which all agencies should subscribe to:** While individual agencies can have their respective

**Figure 29: Using cluster and value chain financing to influence a more inclusive growth of the MSMEs and the financial service providers**



implementation.

**Define the roles of individual agencies engaged in MSME development.** For the system to work, it is essential that the roles and boundaries of individual agencies are well mapped, articulated and agreed upon by all agencies. From our review, we would envision SMEF to be the anchor agency for coordination and management of MSME development. However, whether the refinancing scheme should be undertaken by BSCIC, BB and SMEF at the same time or whether this should be the territory of only BB is an issue that needs to be discussed at the national level. BB is better

mandate, they all need to conform to a central definition and scope for MSME development. The national financial inclusion strategy could work as the central guiding policy. The BB SME Credit and Special Programme could work as the operational policy for financing and MSME cluster and value chain development. BSCIC and SMEF could then have their individual interventions that contribute to the central goals.

**Define cluster and value chain finance from the perspective of development finance and investment:** It is essential that the scope for cluster and value chain finance is defined from

the point of view of development finance. As such, the incentive schemes and the financing instruments should be tailored to mitigate cluster and value chain specific challenges but not just to provide finance at soft terms to only a small percentage of MSMEs within the clusters. This would allow for two substantial changes in the scope for policies for enabling MSME finance- (i) this would allow to utilize the incentive schemes to have larger development impact in the clusters and value chains and increase the overall demand and utilization capacity of finance by the MSMEs in the clusters and the value chains and (ii) this would influence development of MSME financing instruments in recognition to the heterogeneity of the scale and size of operations of the MSMEs and their need for finance. Figure 29 shows the impact of adopting a development financing perspective for cluster and value chain finance.

**Channel incentive schemes towards development need of the cluster and value chains rather than individual MSME financing needs:** The scale of the refinancing schemes made available by ADB and the World Bank is limited. It is not worthy to invest this fund as single digit interest loan to handful of MSMEs in a selected cluster for a shorter period of time. The short term nature of this approach and the limited outreach that could be achieved reduces the impact and effectiveness of the fund. The fund should be used to attract private sector investment to untapped opportunities within the clusters and the value chains. This would help creation of enterprises and facilities that are otherwise dependent on project financing from the government or the development aid agencies.

**Support establishment of private sector cluster development and consultation agencies:** The role of data collection and dissemination is primarily rested with SMEF. However, BB, BIBM, BSCIC, MRA, PKSf, InM all are engaged in data collection and dissemination. Of these agencies InM work as a service provider to the rest of the agencies. The private sector is primarily dependent on the data and information provided by the public sector agencies. Market intelligence and business development and advisory supports thus remain project driven and dependent on external aid financing. In India, aid funding has been successfully used to establish private sector agencies that now work with the enterprises in clusters to solve their specific development need on a commercial basis. These agencies have become the center for

research, innovation, skill development and trade linkage support for the MSMEs. We are yet to see any such agency in Bangladesh. For long term sustainable outcome from the efforts, it is essential to provide incentives to the private sector consulting and business development and advisory support service providers in Bangladesh to establish such cluster and value chain development agencies.

**Pilot the concepts of special purpose vehicle (SPV) for cluster financing:** Most of the clusters that we studied have the need for common machineries centers, training and skill development center, design and product innovation centers. The clusters in Bangladesh belong to the weak cluster categories as per the UNIDO classification as the MSMEs are loosely structured in the cluster. The support services are not well established within the clusters. In India and in Eastern European countries, such problems within the clusters are successfully addressed through establishment of special purpose vehicles which are agencies owned by the associations, or an individual or a group of private and public sector entities. In India, the Government provides grants and equity financing to set-up such SPVs. The experience of India could be piloted in Bangladesh as this has the potential to solve some of the development needs within the clusters which require collective financing streams.

**Establish incentive financing schemes for value chain financing instruments like warehouse receipt and factoring:** Currently, supplier's credit is the major source of finance within the value chains. Our findings show that there are specific requirements for factoring and warehouse receipt financing in many of the clusters which suffer from seasonal spikes in sales. These clusters could benefit from factoring and warehouse receipt financing. However, such financing instruments are yet to be explored. Furthermore, innovative guarantee finance scheme could also be explored in the value chains. During our assessment we have found some cases that show that the interest is present. For instance, PRAN, one of the largest business conglomerates in the country, approached BRAC Bank to issue term loan to its dealers for which the company would work as a guarantor. Incentive financing schemes could be channeled to facilitate wider adoption and exercise of these instruments.

**Build capacity of the trade associations to provide financial counseling and advisory services to the MSMEs; facilitate**

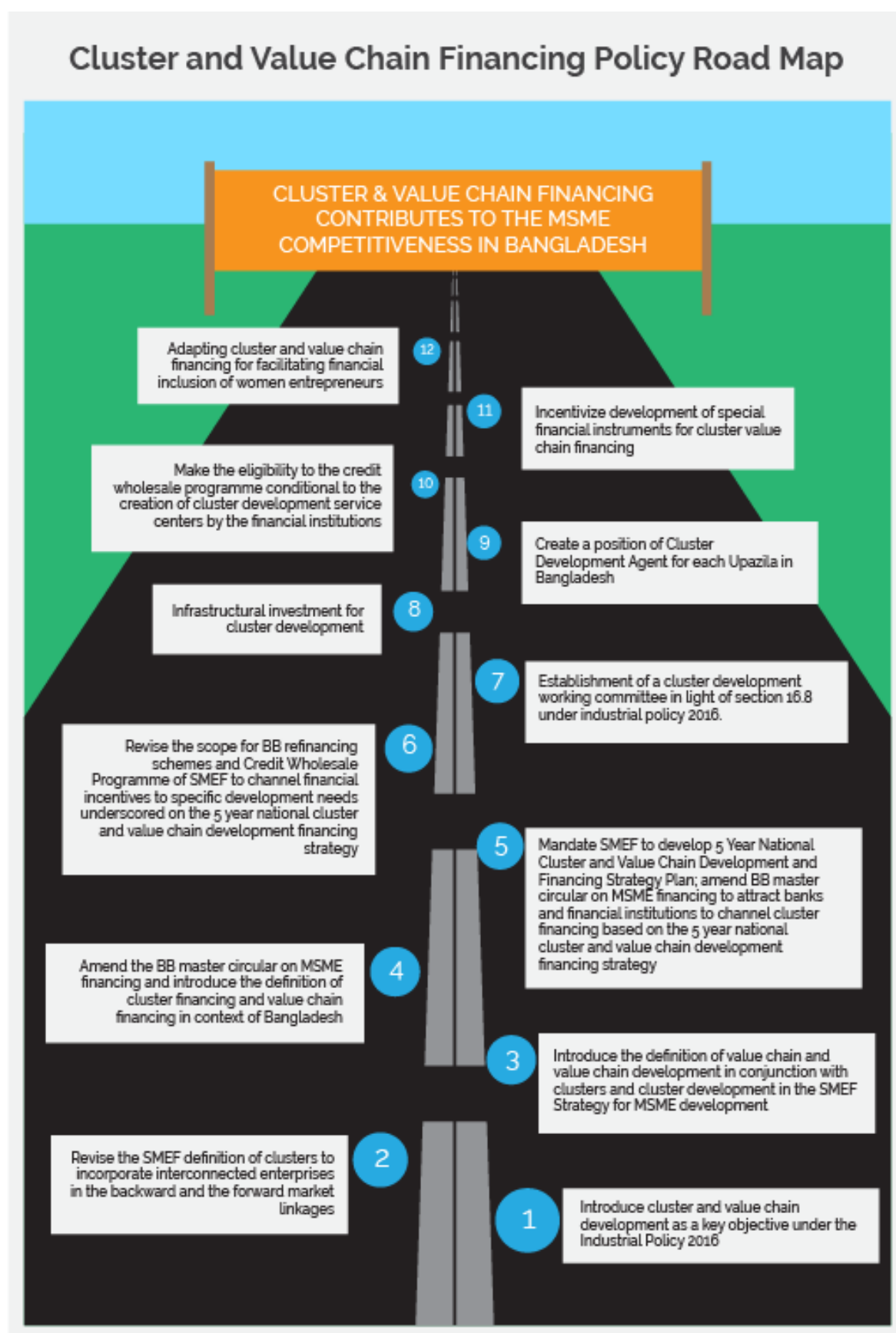
**establishment of associations in clusters that do not have operational associations:**

For cluster and value chain development initiatives to be effective, it is essential that the trade associations are actively engaged in mapping the challenges of their members, disseminating it to national stakeholders and initiate interventions in such contexts. Currently many of the clusters do not have functional trade associations. Initiatives need to be put in place to support development of cluster specific associations. Trade associations can play an active role in financial advisory and credit facilitation support. The associations could work as a liaising center between the FIs and the members of the associations. They could have special units that work as commissioning agents for banks for successful credit facilitation. This could be specially tested for clusters that have more progressive enterprises. This includes the light engineering cluster, the leather goods making cluster, the plastics and other synthetics cluster.

**Establish one stop trade centers for women entrepreneurs:**

One stop trade centers could be established for women entrepreneurs in the divisional headquarters. Depending on the number of women entrepreneurs in the specific division, there could be several trade centers in a city. For instance, in Dhaka, there could be at least six trade centers located respectively in Uttara, Gulshan, Mirpur, Dhanmondi, Lalbagh and Jatrabari. These trade centers would provide a desk for office space and a common finance and administration office that could support them with all their financing needs. The centers could facilitate exchange between the FIs and the women entrepreneurs. The center should run on a subscription basis. BWCCI could work as the anchor agency for management of such center as the organization already holds substantial membership and experience in providing trade facilitation support to women entrepreneurs.

**Figure 30: Road map to establish an institutional framework for cluster and value chain financing in Bangladesh**



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# Annex 1: Methodology

The study was undertaken in five phases, each providing input to the subsequent phase. The study started with kick-off discussion and relevant literature was reviewed. Afterwards, qualitative assessment was conducted in all the selected clusters. After that, a day-long workshop was conducted to analyse the findings from the qualitative assessment. Based on the findings from the qualitative assessment, tools for quantitative assessments were developed and after that quantitative assessment was conducted. After thorough demand and supply analysis the financial expert team from Innovision and MEDA developed recommendations and guidelines for necessary financial products. A brief description of each phase is discussed further in this section.

## 1.3.1 Kick off and Desk Review

**Kick-off Discussion:** A Kick-off Discussion meeting was held between BFP-B and Innovision. The meeting provided a chance for the study team to hear from the client about their needs and requirements for this assignment, and to discuss the methodology proposed. Following the meeting, the study team designed a set of tools to be used during the field research phase of the project. These include interview guides, FGD checklist and questionnaires and a sampling strategy to prioritize key informants. Suggested changes from BFP-B were incorporated into the methodology.

**Literature Review:** The study team conducted an initial literature review of the situation of access to finance in Bangladesh, reviewing documents from sources including Bangladesh Bank, Bangladesh Bureau of Statistics, The Asian Development Bank (ADB), SME Foundation, PKSf, BSCIC, and relevant development projects among others. We also reviewed literature related to cluster and value chain financing in India, Indonesia and the European Union in line with the objective to review relevant global best practices on cluster and value chain financing.

## 1.3.2 Demand Side Analysis

To understand the issues related to the demand side, we undertook both qualitative and quantitative assessment.

**1.3.2.1 Qualitative assessment:** We undertook 27 focus group discussions (FGDs) which represented the selected 30 clusters, in 10 selected sectors. The selection of clusters (provided in table 2) was developed based on the information available in the study titled SME Clusters in Bangladesh, published by the SME foundation in 2013. We selected the sample clusters in proportion to the number of clusters available within the sector (Table 1). The FGDs were undertaken in an open-ended discussion format where the objective was to find out the following information:

- The size and scale of the cluster
- The value chain for the related product
- Financial behavior of the MSMEs across the value chain
- Overall challenges in the value chain
- Challenges related to access to finance

A reconnaissance team was sent to the selected clusters to engage with the associations and organize the FGDs together with the associations. We also undertook Key Informant Interviews with the executive committee members of the associations in the field from the selected clusters in the sectors to understand how they are supporting their members to access finance.

Table 1: Distribution of clusters for qualitative investigation

Sector	Number of clusters	Sample size (cluster)
Handicraft and Miscellaneous	38	4
Agro Processing	34	3
Light Engineering	31	3
Knitwear and RMG	22	4
Aesthetic Design	16	3
Leather Making	13	2
Handloom and Specialized Textile	10	3
Healthcare and Diagnostic	5	2
Plastics and Synthetics	3	2
Electronics and Electrical	3	1
<b>Total</b>	<b>175</b>	<b>27</b>

- Based on the information that was gathered from the SME foundation, we developed a list of clusters under each sector in which we undertook the field investigation.
- We ensured a mix of large clusters (low number of enterprises but high overall turnover -- for instance salt manufacturing cluster in Chittagong; high number of enterprises but low overall turnover-- for instance, rice mills cluster in Sherpur) and small clusters (lower number of enterprises and low turnover; for example, Wood cluster in Pirajpur). This helped us to define the scope of cluster and value chain financing for not only larger clusters but also small clusters, which have future prospect for growth.
- In total 304 respondents provided feedback to the study during the qualitative investigation. Included in the total, **22 women entrepreneurs were individually interviewed** to gather deeper and more nuanced information pertaining specifically to the challenges and opportunities of women-led enterprises and their access to finance.

Table 2: Respondents for In-Depth Interviews and FGDs- Qualitative Assessment

Tool used	Type of Respondent	Number of Respondents
FGDs	MSME owners/ operational directors and value chain actors	282
In-depth interviews	Female Enterprises	22
Key Informants Interview	Executive committee members of the associations (cluster based associations)	2

**1.3.2.2 Quantitative assessment:** The quantitative assessment was undertaken in 60 clusters from 10 sectors. The paper and pencil based survey was undertaken with the MSMEs who were selected through a rigorous sampling procedure.

*Cluster selection:* The quantitative analysis was undertaken in 60 clusters. This included 28 clusters where the qualitative investigation was undertaken. The proportional distribution of the clusters is presented in table 3 based on numbers of clusters within the sector that were identified by the SME foundation.

Table 3: Sector Wise Sampling of Clusters

Sector	Number of clusters	Sample size (cluster)
Handicraft and Miscellaneous	38	10
Agro Processing	34	10
Light Engineering	31	10
Knitwear and RMG	22	9
Aesthetic Design	16	6
Leather Making	13	5
Handloom and Specialized Textile	10	5
Healthcare and Diagnostic	5	2
Plastics and Synthetics	3	1
Electronics and Electrical	3	2
<b>Total</b>	<b>175</b>	<b>60</b>

Location-wise, these clusters were found to be dispersed amongst seven divisions<sup>18</sup>. However, amongst 64 districts, no cluster was found in 11 districts. We identified the clusters for quantitative assessment based on size (small, medium and large), turnover (low, medium and high) of the enterprises in the clusters. The list of 60 clusters for quantitative assessment is also in the Annex. Table 4 presents the division-wise distribution of sample clusters.

Table 4: Division Wise Cluster Selection

Sectors	Barisal	Chittagong	Dhaka	Khulna	Rajshahi	Rangpur	Sylhet	Total
Agro-processing/agri-business/plantation agriculture/specialist farming/tissue-culture	0	2	2	2	2	1	1	10
Designer, aesthetically-challenging, personal wear and effects	0	0	3	0	2	0	1	6
Electronics and Electrical			2					2
Handicrafts and Miscellaneous Sector	2	1	2	1	2	1	1	10
Handloom and Specialized Textile	0	1	2	0	2	0	0	5
Healthcare and Diagnostic	0	0	2	0	0	0	0	2
Knitwear and Readymade Garments	0	0	6	0	2	1	0	9
Leather making and Leather Goods	0	1	2	1	1	0	0	5
Light Engineering and metal Working	0	3	3	2	2	0	0	10
Plastics and Others Synthetics			1					1
<b>Total</b>	<b>2</b>	<b>9</b>	<b>25</b>	<b>7</b>	<b>12</b>	<b>2</b>	<b>2</b>	<b>60</b>

For each selected cluster, a minimum of 30 respondents were targeted to be interviewed. The target respondents included four broad categories of value chain actors as presented in table 5. The

<sup>18</sup> Bangladesh consists of a number of administrative areas called divisions (bibhag). Each division is further split into districts (zila) which are then further sub-divided into Upazilas.

respondents were distributed amongst the four categories based on judgmental sampling method. The assumption was that there are more enterprises at the manufacturing level and subsequently lesser number of enterprises in the backward and forward linkages. As each of the enterprises not necessary have women enterprises, 30 respondents were randomly selected from each cluster.

Table5: Number of Respondents per cluster

Value Chain Actors	Sample Size
Manufacturers	10
Raw material providers	8
Support service providers	8
Buyers	4

Our field team visited the selected clusters and selected the manufactures for interviews. However, the sample selection process was not completely probabilistic sampling as the enumerators' depended on the availability of the MSMEs and undertook interviews with the MSMEs who were willing to attend. In some of the clusters, the target of 30 respondents could not be fulfilled due to unavailability of some of the respondent categories in the targeted clusters (for instance, raw material suppliers could not be identified in the Light Engineering cluster in Naogaon Sadar.). As a remedy, our field team collected the list of other value chain actors from the MSMEs within the clusters and then the required numbers of enterprises were selected for interviews. In total, 1,734 MSMEs were interviewed. This included 594 manufacturers/producers, 446 raw material providers, 458 support service providers and 236 traders. As each of the enterprises not necessary have women enterprises, 30 respondents were randomly selected from each cluster.

**Questionnaire Designing and Pre-testing:** We used 2 sets of questionnaires for 2 separate types of respondents; the manufacturers/ producers and the rest of the value chain actors. We shared the draft questionnaires with the BFP-B team and their feedback was incorporated in the final questionnaire that was used for the field investigation. We conducted pre-testing on five enterprises in Dhaka and incorporated feedback from the pre-test before finalising questionnaires for data collection.

**Selection of Enumerators & Training:** We recruited and trained 35 enumerators with experience in conducting similar surveys. We developed a manual for the training of the enumerators. The manual detailed the background and objective of the survey, methods of seeking appointments with the respondents, manners and etiquette, explanation of and instruction on the questions, description of behavioral conduct before, during and after the interview with tips on managing difficult situations. All the field personnel were given a copy of the training manual as reference. The lead associate along with the field operations manager conducted the training for two days at Innovision office in Dhaka.

Final selection of the enumerators was made based on the performance of a mock test and practice interview. At the end of the mock test and practice interview, all candidates were evaluated and 33 interviewers met the predefined standard and were retained for the actual fieldwork.

**Duties of Survey Supervisors Relating to Data Collection:** We deployed 6 trained and experienced supervisors to ensure that the data collection as per our plan. The supervisors were assigned the following specific responsibilities:

- Supervise the first few interviews by each enumerator, if necessary provide additional training, and if required replace specific interviewers.
- Collect the completed survey forms and conduct full review of the forms for incomplete, omitted or otherwise erroneous data recording practices.
- Conduct a 10% random check of the interviews completed by each interviewer to check for consistency, accuracy and quality of work of each interviewer
- Assist enumerators in securing respondents' participation if necessary
- Provide all logistical support and material to enumerators
- Approve questionnaires for data entry ensuring that the assigned enumerators do not overlook inconsistencies and skip patterns

**Field Quality Control:** Data collection quality was ensured through stringent quality control mechanisms through multiple steps as follows:

- A stringent recruitment and training procedure.
- Call backs and scrutiny: Survey supervisors checked all completed questionnaires and conducted a minimum of 10% call-backs (physical call back) in order to verify the accuracy of the data recorded and, where deemed necessary to clarify with respondents any inconsistencies in their answers. We accomplished this task in the following manner:
  - Call back (over phone) 10%
  - Physical call back 10%
  - Response verification 20%
  - Check filled-in questionnaire 100%

Corrective actions were taken immediately if any gaps or deviation was found. Two dedicated executives conducted sample verification over phone.

**Data Entry, Cleansing, Processing and Analysis:** Data entry was done by our experienced data entry operators, who were trained on the survey questionnaire by the lead associate and field survey manager prior to the data entry operations. All data entry was done in-house to ensure security and better control. Figure 1 shows the data entry and coding procedure.

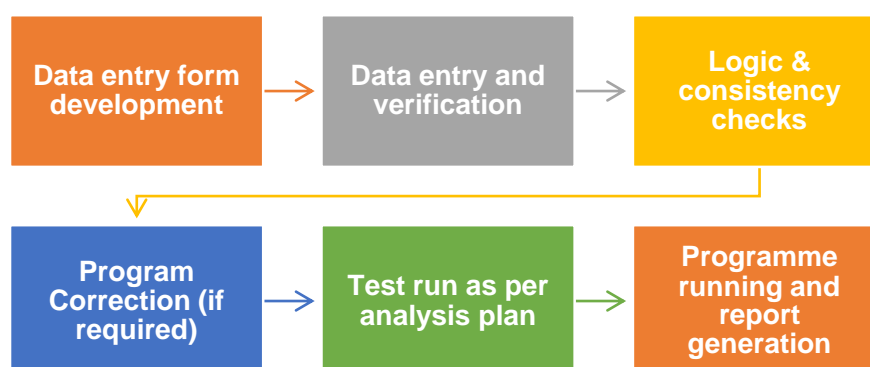


Figure 1: Data Entry and Coding

### 1.3.3 Supply Side Analysis

We used qualitative research methodology to undertake the supply side analysis. We conducted the interviews in two phases. In phase 1, we conducted interviews with the senior staffs of selected Financial Institutions in their head offices in Dhaka. We undertook phase 1 interviews with 25 financial institutions as per the following schedule.

- i. State Owned Institutions **(1)**
- ii. Private Commercial Institutions
  - a. Private Commercial Banks **(7)**
  - b. Islamic Banks **(2)**
  - c. Non-Bank Financial Institutions **(4)**
  - d. Foreign Bank **(1)**
- iii. Microfinance Institutions
  - a. ASA, Grameen Bank, BRAC, BURO Bangladesh
  - b. PKSf MFIs (7 MFIs; MFIs that have operations in the clusters where the primary investigation was undertaken)

The institutions were selected based on the following filters:

- Cluster/value chain lending experience
- MSE portfolio size
- Refinancing received from BB: Most & Least

The list of FIs is provided in the Annex of this report. In phase 2, we conducted interviews with staff of the financial institutions in the areas where the qualitative investigation (FGDs) were undertaken.

Demand and Supply side sample size in total:

Tool used	Type of Respondent	Number of Respondents
In-depth Interview	Financial institutions (head office representatives)	25
In-depth Interviews	Financial Institutions (branch offices) and informal channels for credit (includes, value chain intermediaries, local money lenders and others as identified in the FGDs)	20

### 1.3.4 Analysis of Support Functions

Interviews with support functions actors were also carried out simultaneously in order to understand their role in cluster and value chain financing. Interviews were conducted with Bangladesh Institute of Bank Management (BIBM), SME Foundation, Institute for Inclusive Finance & Development (InM), Bangladesh Women Chambers of Commerce and Industries (BWCCI), Bangladesh Electrical Merchandise Manufacturers Association (BEMMA), Bangladesh Plastic Goods Manufacturers & Exporters Association (BPGMEA), Leather goods and Footwear Manufacturers and Exporters Association of Bangladesh (LFMEAB) and Bangladesh Engineering Industry Owners Associations (BEIOA). Our team conducted 10 interviews in total for this purpose.

### 1.3.5 Analysis of the Regulatory Environment

Concurrently, a policy analysis was carried out, where the team interviewed key personnel working with SMEs and cluster financing experience in various government and non-government institutions, including, BB, SME Foundation, Bangladesh Small and Cottage Industries Corporation (BSCIC), Microcredit Regulatory Authority (MRA), Palli Karma-Sahayak Foundation (PKSF), National Association of Small and Cottage Industries of Bangladesh (NASCIB). Development partners such as IFC who work with MSE financing was also reached out. The policy analysis also involved an extensive desk review of the MSME development and MSME financing policies in Bangladesh. The study team also looked into MSE cluster and value chain financing practices and policies that have been tried and tested, including from India, Pakistan, China, Indonesia, Philippines, Italy and Latin America, where SME clusters have thrived to bolster economic and social development of the countries.

Table 1: Respondents for Key Informant Interviews

Tool used	Type of Respondent	Number of Respondents
Key Informant Interview	Government/Non- Government/ Development Personnel	7
Key Informant Interview	Service Providers (Associations, SME foundation)	10

### 1.3.6 Analysis workshops

The research team conducted two one-day internal workshops to analyse the findings from the qualitative assessment and the quantitative assessment. The team brainstormed about possible interventions to mitigate challenges faced by the stakeholders and recommend possible policy interventions.

# Annex 2: Review of the Support Market Systems for Cluster and Value Chain Financing

## Incentive Financing Schemes

Low cost funds for banks are available from Bangladesh Bank through various schemes setup with long term, low cost loans from multilateral agencies such as the World Bank, Asian Development Bank, JICA, etc. to encourage banks to lend to MSMEs. The Government of Bangladesh has also provided funds for these facilities. The Seventh Five Year Plan (2016-2020) has made provision for subsidized credit to clusters, disadvantaged groups and backward regions with close monitoring.<sup>19</sup>

SME Foundation offers banks pre-financing at a subsidized interest rate of 4% p.a. to reach out to MSMEs and provide funding at subsidized interest rate of 9% p.a. The banks receive funds in advance. This is intended to provide an incentive to the banks to seek out bankable micro and small enterprises and lend to them. The banks can only lend to the MSMEs once using the funds from SME Foundation. The SME Foundation funds are limited and this is the only way to ensure that more MSMEs can get access to finance. For example, a bank can lend at 9% to MSMEs that meets their criteria. If these loans are repaid as per the terms agreed and the MSMEs want to take another loan, the bank cannot use SME Foundation to do this. This means that the borrowers that had performed well and should be considered lower risk, have to borrow at a higher rate than when they were untested.

Bangladesh Bank through the SME and Special Projects Department offers refinancing facilities to banks and non-bank financial institutions to lend to MSMEs. The refinancing to banks is at the bank rate (currently 5%). Banks can lend to MSMEs at competitive rates. Bangladesh Bank caps the interest rate at 5% of the bank's cost of fund except for loans to women owned entrepreneurs where the interest rate is 10% p.a. Unlike for the funds from the SME Foundation, there is no limit on how many times an SME can be financed by the bank.

The Financial Inclusion Department also has a refinance scheme targeting financing of micro and cottage industries where the loan amount does not exceed BDT50,000. The funds are made available to the banks at the bank rate (5%). An additional incentive is provided to the banks when the borrowers repay the full amount of the loan on time. Here the bank gets an additional discount of 3.5% on the interest amount making the effective interest rate for the bank 1.5%. This is intended to encourage banks to engage in closer monitoring and providing mentoring to the borrowers so that they are able to run their business well and grow it. The goal is for the borrower to graduate from BDT50,000 loans to higher ones where the incentive scheme provided by the SME & Special Projects Department takes over. Banks are able to on-lend these funds to MFIs at 7%, i.e. with a 2% mark-up. The discount of the interest rate in case of good performance by the borrower is split between the MFI and the bank (2.5% and 1% respectively) so as to encourage both the financial institutions to engage in mentoring the borrower. This facility is also appropriate for cluster based financing as it allows group lending to up to BDT5 lac to 10 members. Bangladesh Small and Cottage Industries Corporation (BSCIC) has two lending windows. One is funded by the GoB and the other by United Nation's Capital Development Fund (UNCDF).

These incentives for lending to MSMEs have certain benefits, i.e. banks seek out MSMEs to lend to gain access to low cost funds. However, the lending will only continue as long as these funds are available. This is particularly true of those schemes where the interest rate is capped below market. However, early stage financing provided by the FID may be a good way to incentivise cluster development.

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<sup>19</sup> [http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/322/11.%207th%20Five%20Year%20Plan\(Final%20Draft\).pdf](http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/322/11.%207th%20Five%20Year%20Plan(Final%20Draft).pdf) (page 228)

## Digital Financial Services

Digital Financial Services (DFS), namely mobile and agent banking, have been allowed by the Bangladesh Bank to help financial institutions increase their reach across Bangladesh. The first phase in the development has been in the form of money transfer that has also facilitated the disbursement of remittances at affordable cost to the banks and the beneficiaries. Under the National Financial Inclusion Strategy, the government and Bangladesh Bank are working on the “first and last mile” inclusion where mobile financial services and agent banking are located front and centre in bridging the first and last miles of financial access across Bangladesh<sup>20</sup>.

However, the next step in the development is the use of DFS for providing access to finance to MSMEs throughout Bangladesh. In order for this to become mainstream, the use of agents by the banks for offering banking services is potentially a key means by which cluster development activities can take place. These activities can be done through private sector service providers, MFIs and/or in-house capacity building of the agent representatives in an effort to assist them generate additional business at the agent outlets. The creation of bankable businesses will probably start with capacity building of MSMEs to get them ready to manage their business and utilise loans to grow their businesses.

A major impediment to the use of mobile banking facilities is the high cost of transaction for everyday use. Beneficiaries are happy to use mobile banking services for one-off money transfers but BDT18/20 per complete transaction makes it difficult for MSMEs to use for all transactions.

A case may be made for mobile banking in terms of security, transportation and time cost savings for making deposits in person at a bank. However, for a population that is largely cash based, this is still a hard sell.

However, the advent of agent banking provides potential for partial savings in terms of transportation and time costs with agent banking outlets poised to be closer to MSMEs than bank branches as more and more agent outlets are set up. The free deposit and withdrawal facility potentially sweetens the deal for MSMEs.

## Credit Information Bureau and Credit Rating

Defaulting on business procurement related financial obligations still do not result in any penalties leaving an opportunity to avail and abuse the system. Many large buyers abuse the supplier's credit by withholding payments for significantly longer periods of time over and above the agreed terms of credit. There are countless examples of this happening especially in the plastics and packaging industry where the number of suppliers is relatively large and competition for supply contracts results in already long credit periods which are further extended by the buyers at will and without penalties.

A Credit Information Bureau (CIB) exists and is fully functional, it only collates information on loans and advances from banks. Unlike more developed markets, there is no entity in Bangladesh that collects, collates and produces information on the repayment behaviour of an individual or an enterprise. CIB information is only available to banks and non-bank financial institutions. All entities get good credit reports as long as they regularly repay their bank and NBFIs obligations.

A Credit Information Bureau (CIB) for microfinance has been in the planning for many years. The Seventh Five Year Plan (2016-2020) has planned for this to be established<sup>21</sup>. The present CIB is a very robust system that has the capacity to incorporate the MFI.

It is noteworthy that if it were possible to report a buyer for paying late or not paying at all, it may not impact the buyers much due to the sheer number of suppliers waiting in line to work with them. MSMEs

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<sup>20</sup> National Financial Inclusion Strategy <http://www.faisalahmed.org/wp-content/uploads/2017/03/NFIS.pdf>

<sup>21</sup> [http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/322/11.%207th%20Five%20Year%20Plan\(Final%20Draft\).pdf](http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/322/11.%207th%20Five%20Year%20Plan(Final%20Draft).pdf) (page 78)

have taken this to be the norm and as such may not care that the buyers pay late as long as there is hope that they will pay. This would benefit the entire country if it were built to scale.

Credit rating agencies are operating in Bangladesh to rate the performance of companies but does not include feedback from suppliers as described above. Although credit rating is suggested by Bangladesh Bank, it is not mandated.

In the case of micro and small enterprise loans, the cost of credit rating needs also to be considered as this is passed on to the borrower. In most cases, credit rating is not taken for loans below BDT10,000,000 and only to a limited extent for loan in excess of that. Bank's are reluctant to use external analysis in making credit decision because the agencies are not accountable for errors in analysis while the bank's internal analysts are.

## Market Intelligence and Information

The financial institutions need intelligence on the scope for MSME financing in clusters and value chains. The policy regulators need to know the challenges and prospects prevailing in these MSME clusters and value chains so that they could create an enabling environment for financing the MSMEs in these clusters. The MSMEs on the other hand need to know the available financial instruments and schemes that they could subscribe to.

Bangladesh Bank in its SME Credit Policy and Programme Document provides a list of prospective clusters in the 64 districts in Bangladesh. The document however does not provide detailed information on the nature and performance of these clusters. SMEF in its study titled 'SME Clusters in Bangladesh' provides a list of 170 prospective clusters in 11 Sectors that are categorized into booster and non-booster sector. The SMEF study also provides a short brief on each of the clusters. This brief provides data on the number of enterprises in the clusters, the revenue of the clusters and the enterprises in the clusters. It also identifies challenges prevailing in the cluster. Besides, the SMEF study provides a review of the status of raw materials supply, machineries usage, skills of workers, capacity utilization of the enterprises in the clusters and their challenges. This document is now being used as a reference for MSME clusters in Bangladesh by the development aid agencies. However, it is not clear whether this is being used as a reference by the SME department in BB and the financial institutions in Bangladesh. The SMEF document albeit comprehensive, does not provide a cluster specific roadmap for development which could work as the onus for financing for cluster and value chain development. The Seventh Five Year Plan (2016-2020) has called for the creation of detailed upazila level map of SMEs to identify clusters<sup>22</sup>. It is not clear whether this mapping exercise is meant to be used as an input for development of a cluster development strategy in Bangladesh.

We can observe that the financial institutions are generally not interested in investing in gathering market intelligence on MSMEs as they consider the market to be too small. Most information about potential clusters has been primarily projects driven as is the case with the SMEF report on clusters in Bangladesh. Government as well as donor agencies have funded these projects.

Some associations have been proactive in accumulating and disseminating information regarding their industry while others have not been very engaged. This is an area where the associations are failing and some monitoring of association activities vis-à-vis member development should be brought under the preview of regulating authorities. These associations are well placed for cluster development activities in collaboration with various governmental agencies.

It is noteworthy that although bankers are not investing much time and money in gathering intelligence, when clusters are identified, they are at least interested in exploring whether these businesses meet their lending criteria. If linked with cluster and business development activities many more MSMEs will be able to access finance.

The MSMEs rely on their friends and family and their peers to learn about available financial products or instruments. While representatives of the SME units of some banks proactively engage with the

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<sup>22</sup> [http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/322/11.%207th%20Five%20Year%20Plan\(Final%20Draft\).pdf](http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/322/11.%207th%20Five%20Year%20Plan(Final%20Draft).pdf) (page 228)

MSMEs in clusters, generally the engagement can be termed as weak or absent. There is no public source from where the MSMEs can avail information on financing instruments and schemes that are available. Most clusters do not have functional associations. Those that have, do not engage on providing financial advisory support to their members.

The mobile network operators (MNOs) are engaged in providing value added services on agricultural and health issues. They are yet to realize the potential of providing information on finance. Mobile phone technology is yet to be harnessed as a potential source for financial advisory support to the MSMEs. The print and broadcasting media are not fully and strategically engaged in collection, analysis and dissemination of information on MSME clusters in Bangladesh. Their engagement is loosely connected to generic policy recommendations. These are not enough to influence financial institutions or provide them directions with regards to cluster and value chain financing.

## Training, Capacity Development, Business Development and Advisory Services

SME Foundation as well as other stakeholders engaged in cluster and value chain development often engage in training activities that are useful although not usually sustained over the long term. For bankers, a major source of training is the BIBM in addition to limited private sector training programs. BIBM's support to the banking sector is in line with the skills needed for conducting banking operations. Most of the training programs offered are related to day to day banking operations as well as technical skills that are needed regardless of which types of businesses the bankers are targeting. For example, credit assessment, risk management, collections techniques, etc. are needed in consumer, corporate and MSME banking operations. Similarly, bringing to the financial sector new knowledge and strategies for conducting and improving banking operations is a priority. As cluster development is not considered a core banking function, the main support provided in this area is in the training programs mentioned above. More focused approach to financing will come once cluster and value chain become better defined and cluster development activities have begun to result in sizeable business opportunities for the banks.

As the demand side analysis shows, the MSMEs in the clusters require skills development support, trade linkage support, product development support, research, development and innovation support. These business development services are primarily driven by specific donor funded projects, for instance, EU-PRISM and INSPIRED, and SDC SKILLFUL. We are yet to see commercial business models in Bangladesh for operating such centers. MSMEs continue to depend on apprenticeship based training. Changing these models would require long term strategic approach to cluster development which we are yet to see. BSCIC is mandated to provide skills development, research and product development, market intelligence, industry establishment support to the enterprises within BSCIC area. Many of the clusters are outside the BSCIC territory and they thus remain outside the scope for strategic support to address their training and capacity development needs. In the private sector, we are yet to see any organization dedicated on cluster development. There are organizations in India (for instance clusterpulse.org) that specialize on cluster mapping, cluster development strategy, trade linkage and market facilitation support.

Microcredit wholesale agency PKSf is working on cluster development and value chain development through the partner NGOs or MFIs that lends from PKSf. PKSf is currently implementing a project titled 'Promoting Agricultural Commercialization and Enterprises' which is mandated to develop trade and product specific value chains in selected clusters across the country. The project is jointly funded by PKSf and the International Fund for Agricultural Development (IFAD). The project is providing support to MSMEs on two fronts. On one front, the MSMEs continue to receive the different microfinance packages from the PKSf partner NGOs. On the other front, PKSf is providing training, business advisory, market linkage, market facilitation support to address specific issues on the selected value chains. For instance, in the crab fattening value chain in the south, the project financed establishment of a crab hatchery. The project has now established an e-market platform to provide internet based marketing services to microenterprises that are participating in the project. Such developmental role facilitates the enterprises to make better use of their finance. In other words, PKSf is undertaking a developmental role to solve non-financial challenges of the MSMEs that have direct

impact on the MSME's capacity to make effective use of finance from the MFIs from which they are borrowing.

## Infrastructural Support

Cluster development would require infrastructural development support to improve road connectivity, to set-up common facilities (for instance, warehouse and storage) and such. BSCIC is tasked to develop infrastructure for the BSCIC territories. Assessment of the infrastructural development requirement in clusters outside the BSCIC territories and introduction of incentive finance schemes can stimulate private sector's investment on specific infrastructure that can contribute to the growth of the clusters. Given that BSCIC's role is limited to its own operational area, a new national cluster development agency could be set-up under the SMEF to define infrastructural development need and secure public or private financing in that regard.

## Advocacy

For cluster and value chain development the grassroots level challenges need to be accounted for. Trade associations can play an active and influential role in this regard. Our findings show that most of the clusters do not have operational and active associations through which the enterprises in the clusters can raise their issues to the national stakeholders. The booster sectors, for example, light engineering, plastics, agro-processing, leather shoes, have formal and active associations which work closely with development partners. Our findings suggest that the support from donors and public agencies are reaching out to sectors and clusters that have active associations. We did not find active engagement of the national stakeholders on developing associations or operationalizing the associations in sectors and clusters that are weekly represented. Cluster development is not active agenda of the associations that are active. The engagement of associations in supporting members to access financing is either weak or absent. Some of the associations, (for instance the light engineering association in Sutrapur, Dhaka) have worked with SMEF on selecting eligible enterprises for the single digit interest loan under the refinancing scheme. Apart from such project driven engagement, we do not see associations to have an active role in supporting members to access finance. The advocacy agenda seems to be focused and limited to VAT and Taxation policy of the government.

Bangladesh Women Chamber of Commerce and Industries (BWCCI) provides advocacy support to women entrepreneurs. BWCCI claims to have contributed to the set-up of the women entrepreneur desk in the branch office of the banks. They have also successfully advocated on MSME loan on single digit interest for women entrepreneurs. BWCCI is working to support women entrepreneurs become bankable or bank ready. In this context BWCCI supports its members to develop business profile, accounting system, production plan, business plan and financial plan. BWCCI has about 5000 members. It provides training services, exhibition participation support and individual counseling to its members. The organization also provides support to the members to file for Trade License, VAT, TIN and Tax certificates. It has divisional committee in all 8 divisions in Bangladesh. BWCCI is working closely with development partners on the agenda for women's financial inclusion.

The National Association of Small and Cottage Based Industries (NASCIB) plays important role in coordination between the national stakeholders (BB, SMEF, BSCIC). The agency can play influential role in connecting financial institutions to its members as a credit brokerage agency. The agency shared its willingness to lead a multi-stakeholder cluster finance committee represented by a lead bank, local chamber, a district credit committee and an advisory council. The network and lobbying capacity of organizations like NASCIB has to be harnessed to stimulate cluster development and value chain development in Bangladesh and channel external financing to the enterprises in the clusters.

## Government Regulations

SME promotion and development is an important policy target for the government of Bangladesh. There are several policy documents and regulations of various government agencies for SMEs. Policy areas include SME cluster development, financing and SME women entrepreneur empowerment. Bangladesh Bank issued the Small and Medium Enterprise (SME) Credit Policies & Programmes that serves as a

guideline for financing of SMEs. The government of Bangladesh has a National Financial Inclusion Strategy that provides a roadmap for actions to achieve financial inclusion. The Seventh Five Year Plan FY2016 – FY2020 expands on the plans of reaching targets regarding various economic and socio-economic aspects; including SMEs. The Bangladesh Institute of Development Studies has published the Strategy for Development of the SME Sector in Bangladesh. The SME Foundation supports research and development of ideas and findings related to the SME sector. The Bangladesh Women Chamber of Commerce and Industry advocates on behalf of the women entrepreneurs and supports research and development activities. Besides these several research papers and articles exist that discourse the rules and regulations regarding SMEs.

Bangladesh Bank shared the roadmap for cluster development in the SME Credit Policies & Strategies. As per the policy BB envisions to take several measures for cluster development: a) identify cluster, b) form committee for cluster development, c) conduct baseline and diagnostic study, d) fix action plan, e) implement action plan, and f) review and monitor.

Bangladesh Bank also shared the financing strategy for SMEs in the same document. As per the document-

- Bangladesh Bank is committed to facilitate SME financing through the refinancing window. The central bank plans to extend a refinancing scheme of BDT 6.6 billion with fund arranged from Asian Development Bank (ADB).
- In the SME Credit Policy & Strategies priority for financing is given to small enterprises; at least 40% of total SME credit disbursement target is planned to be reserved for small enterprises.
- Women entrepreneurs get special priority for financing according to the SME Credit Policy of Bangladesh Bank. Commercial banks can charge a maximum interest rate of 10% to women entrepreneurs. Banks and Financial Institutions are allowed to provide loan of maximum amount of BDT 2,500,000 against personal guarantee for women entrepreneurs. Banks and financial institutions will give special advice to women entrepreneurs through service centres. BB has allocated at least 15% of the refinancing fund for SME sector for women entrepreneurs.
- Banks/FIs can provide collateral free credit facilities up to BDT 2,500,000 against personal guarantee in SME sector; especially for small and women entrepreneurs. Loans can be provided against hypothecation of products and machineries. But banks/FIs are to follow their own rules and banker-customer relationship to set collateral for loans more than BDT 2,500,000.

The Seventh Five Year Plan of the government proposes a 3 step strategy for developing the SME sector with export orientation. First, the naturally developed capabilities serving the domestic market need to be consolidated through some form of protection. Second, the entry of SMEs into the export market needs to be made easier. The third step stresses the enhancement of capacities to excel in the global market. Further plans for the SME sector include:

- The plan emphasizes on identifying areas of comparative advantage by strengthening the role of SME Foundation and conducting a national SME census through Bangladesh Bureau of Statistics (BBS) to create a comprehensive data bank regarding SME sector.
- The Plan suggests a differentiated indirect tax system for SMEs; given their structural difference in comparison to large-scale enterprises.
- It also proposes liberalization measures to allow easy access to imported inputs for SMEs.
- More public expenditure should be channelled towards the agricultural and rural sector to raise the purchasing power of the rural citizens. This would increase demand for SME products as this sector of the population's demand is oriented towards local products.
- The Seventh Five Year Plan draws importance on the role of the SME Foundation to develop an action plan for SME cluster development. The action plan will be developed on information of credit and other requirements that can be identified through a national survey.

- In order to promote women entrepreneurship, the SME Foundation has been working to bring women entrepreneurs in mainstream development process. Other activities proposed include institutional capacity building of women chambers and trade bodies, formulating gender action plan, encouraging banking finance for women entrepreneurs, organizing women skill development programme and so on.

The ministry of Industry prepared The National Industrial Policy in 2016. It provided the objective of the ministry to provide support services to the SME sector and to remove barriers. Support services include providing pre-advice to women entrepreneurs, utilising national training institutions to provide training for increasing efficiency and competitiveness of SMEs, liaising with other ministries to include SME development in their plans, and so on.

The SME Foundation was set up in 2007. It performs several functions that cater to the SME sector. It advocates for fair policies for SMEs. An important function has been credit wholesaling which involves the provision of collateral free SME loans at 9% interest. It also works to develop women entrepreneurship by building institutional capacity of women chambers and trade bodies. Other functions include capacity building and skill development, access to technology, providing business support services and so on.

According to a study conducted by BIDS in 2015, the number of loans disbursed increased from roughly 8000 beneficiaries to 36000 between the time-period 2007-2008 and 2012-2013. This can be attributed to disbursement of women entrepreneur loans; provided at a single interest rate. This increased the number of loan disbursement among women only while other category loan disbursements in SME sector did not rise as much. Women entrepreneurs in Bangladesh make up 5-6% of total business enterprises in Bangladesh (Ahmed, 2014). Findings from INSPIRED SME Survey 2013 further substantiates that the major constraint for SMEs is lack of credit. It was identified as the main constraint by 68.6% of small and 44.7% of medium entrepreneurs.

## Normative Behaviour of the MSMEs

Most of the MSEs have predominantly cash based operations partly because the MSMEs generally don't have sufficient funds left over to deposit at the bank after they have paid for their day-to-day expenses such as payments to vendors for raw materials and inventories, salaries, other expenses. These transactions are done on cash basis.

Most entrepreneurs do maintain cashbooks against which bankers are able to estimate their revenue and costs. However, independent corroboration is difficult in the absence of bank statements reflecting the same.

A large segment of the MSEs that could transact through a bank account choose not to do so due to the fact that the tax authorities assume that any fund deposited into the bank is from sales and therefore taxable. Most MSEs do not have the capacity to maintain records to be able to net off the expenses. As a result, they feel that transacting through the bank will result in their paying more income taxes and VAT than should be due from them.

The demand side analysis that we conducted show that the MSMEs mostly need working capital financing for short period of time. The need is often triggered by sudden order from a buyer or a seasonal increase in sales. To meet such sudden requirement, MSMEs resort to their friends and family members and if they are unable to source funding they resort to informal money lenders since the finance is readily available. Also, there is no paperwork involved and this means the MSMEs are able to discount the tax and VAT that they would have to otherwise pay for if they were transacting through banks to increase their credit worthiness. Such deeply rooted normative practices of the MSMEs and the resulting informal financing system obstruct the growth of a competitive formal financial market serving the MSMEs need.

## Inter agency coordination and collaboration

Several government agencies are engaged in regulating the policies and undertaking the interventions for MSME development in Bangladesh. SME Foundation, Bangladesh Small and Collage Industries Corporation (BSCIC), Bangladesh Bank (BB), MRA, PKSf are among the key players in the development of MSMEs in Bangladesh. There need to be a rationalisation of the functions that these institutions perform.

For example, it may be more efficient to allow Bangladesh Bank to provide incentives to the banks to lend to MSMEs while SME Foundation focuses on cluster development activities. These activities may involve using the relatively small amount of funds that they have been using for their pre-finance scheme to finance, directly or through a bank, equipment and machinery to be used by MSMEs in clusters. Many sectors have remained underdeveloped due to lack of testing facilities or equipment that are too expensive for a single enterprise but needed for production of higher quality products. An entity could be set up to provide the service for a fee that would enable repayment of subsidized loans along with the operating expenses of the company.

If their mandate allows, SME Foundation could be an equity participant in setting up the entity thereby fulfilling the function of a venture capital agency. This would include training programs on 'entrepreneurship development, and training related to SME cluster wise skill, technology, ICT, training of trainers, productivity and quality improvement, marketing, management, financial management, etc.'<sup>23</sup> Certainly, the financing would need to be partnered with mentoring and capacity building of the cluster members.

## Defining the Scope for Cluster and Value Chain Financing

The SME Foundation define a cluster as 'a concentration of enterprises producing similar products or services and is situated within an adjoining geographical location having common strengths, weaknesses, opportunities and threats.'<sup>24</sup> Bangladesh Bank does not have a robust definition for cluster but rather alludes to geographic concentration that will be 'helpful for the bank's risk analysis and intensive monitoring of SME financing'<sup>25</sup>. BIBM has suggested that in addition to geographic concentration there is a need for networks, linkages competition and cooperation among the enterprises to reap the true benefits of cluster based financing<sup>26</sup>. In fact, BIBM goes further to suggest that before cluster based financing can become mainstream, more work need to be done with respect to cluster development.

The tendency has been on a producer centric definition of clusters that narrows the focus for the financial institutions exploring the viability of cluster based financing. Viability of cluster based financing depends on the amount of business that can be generated from it.

Similarly, value chain is also not defined officially but needs to be. Bangladesh Banks' SME Credit Policies and Programmes guidelines do not define or refer to value chains. Although clusters and value chains are distinct from each other, the two definitions need to be looked at together, particularly if interdependencies among the MSMEs are to be included in creating business opportunities for financial institutions through cluster and value chain development activities.

Most banks interviewed were somewhat aware about cluster as a result of Bangladesh Banks' reporting requirements but none had an official definition for cluster. The banks reporting financing in various clusters have been doing so using their own understanding of what a cluster is. The majority of the financing in the clusters occurs as part of banks' regular financing activities. Clusters were identified after the financing had taken place.

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<sup>23</sup> [http://www.plancomm.gov.bd/wp-content/uploads/2015/02/2\\_Strategy-for-Development-of-SME-in-Bangladesh.pdf](http://www.plancomm.gov.bd/wp-content/uploads/2015/02/2_Strategy-for-Development-of-SME-in-Bangladesh.pdf) (page 20)

<sup>24</sup> SME Clusters in Bangladesh, March 2013, SME Foundation:  
[http://www.smef.org.bd/media/publication/sme\\_cluster\\_bd\\_smef.pdf](http://www.smef.org.bd/media/publication/sme_cluster_bd_smef.pdf)

<sup>25</sup> Small and Medium Enterprise (SME) Credit Policies & Programme, SME & Special Programmes Department, Bangladesh Bank

<sup>26</sup> BIBM Research Monograph 16: <http://ssadmin.bibm.org.bd/notice/10-02-16/Research%20Monograph%2016.pdf>

Banks have mentioned that even in cases where clusters have been identified by SME Foundation, the banks were unable to finance all of them enterprises as they did not meet the banks' lending criteria. The banks' felt that cluster development was not their job.

Most banks do not consider value chain financing as a strategy for market penetration. Any value chain financing being done, for example, financing of vendors to large organizations, are being done as part of the banks' regular operations, i.e. seeking out businesses that meet their criteria for lending.

## Business Norms of the Financing Institutions

Management buy-in is required at financial institutions for the cluster and value chain financing to be developed because staff at the grassroots level needs to be empowered and incentivised.

The banks' leaders are not creating sufficient interest or challenging bank staff to reach out to business that either have the potential to grow or create a group of businesses that work together to achieve synergies. This will enable the institutions to gain a better understanding of the relationships that govern the success of these businesses and therefore lead to the development of appropriate products and monitoring tools. In an underserved market, first mover advantage in a particular area can create significant momentum across the country in the form of free publicity and therefore greater business development opportunities.

Unfortunately, this has not happened and although senior management are aware of the benefits of cluster based financing, staff at the grassroots level are operating with traditional financing strategies. The knowledge is not disseminated in a systematic way across the organisations but even in organisations that have cluster and value chain financing portfolios, it has been due to the efforts of some bankers that are exceptions rather than the norm.

Bangladesh Bank requires that mortgaged property is within 30 square kilometres of the branch for monitoring purposes. MSMEs are not able to conform to this regulation. They have stated that although they may have property to mortgage in other district but not where they live and operate their business. This prevents them from access to finance. It may be possible for the banks to use their branch network to monitor the land being mortgaged outside of this radius.

The Money Loan Court Act was enacted in 1990 to ease the difficulty of liquidating mortgaged property in case of loan default. However the underdevelopment of the second hand property market has resulted in mortgage collateral being largely ineffective securing lenders<sup>27</sup>. This is more often the case for large borrowers, However, most continue to insist on mortgage of property if only to exert some level of pressure to ensure full and timely repayment. However, financial institutions have found that smaller players who often lack property to mortgage<sup>28</sup> are more easily pressurised to repay loans if there are able to secure property mortgage against loans even if the property is unlikely to be liquidated very easily.

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<sup>27</sup> [http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/322/11.%207th%20Five%20Year%20Plan\(Final%20Draft\).pdf](http://www.lged.gov.bd/UploadedDocument/UnitPublication/1/322/11.%207th%20Five%20Year%20Plan(Final%20Draft).pdf) (page 518)

<sup>28</sup> [http://www.plancomm.gov.bd/wp-content/uploads/2015/02/2\\_Strategy-for-Development-of-SME-in-Bangladesh.pdf](http://www.plancomm.gov.bd/wp-content/uploads/2015/02/2_Strategy-for-Development-of-SME-in-Bangladesh.pdf) (page 13)

## Annex 4: Comparative review of financial products of the formal and informal financial service providers

Financial Institutions / Source of Finance	Type of Loan	Rate of Interest	Eligibility Criteria	Required Document
Bank	Working capital loan/Overdraft	12%-16%	<ul style="list-style-type: none"> <li>▪ Having property/land/building</li> <li>▪ Minimum of 2 (two) years of experience in the line of business</li> <li>▪ Business must be a going -concern with more than 1 (one) year in operation</li> <li>▪ Minimum age of 18-years</li> <li>▪ Valid trade license</li> <li>▪ Minimum income must commensurate with the amount of loan applied for</li> <li>▪ Transaction history of minimum 6 months with the bank</li> </ul>	<ul style="list-style-type: none"> <li>▪ 1(one) copy passport size photograph of intending borrower(s) as well as guarantors(s).</li> <li>▪ Valid Trade License</li> <li>▪ TIN certificate</li> <li>▪ Bank statement for last 6-12 months</li> <li>▪ Financial statement.</li> <li>▪ Original title deed</li> <li>▪ Bia deed</li> <li>▪ CS, SA, RS &amp; Hal Parcha</li> <li>▪ Mutation with DCR</li> <li>▪ Up to date rent receipt</li> <li>▪ Site Map/Municipal tax receipt</li> </ul>
	Term loan	12%-16%	<ul style="list-style-type: none"> <li>▪ Having property/land/building</li> <li>▪ Minimum of 2 (two) years of experience in the line of business</li> <li>▪ Business must be a going -concern with more than 1 (one) year in operation</li> <li>▪ Minimum age of 18-years</li> <li>▪ Valid trade license</li> <li>▪ Minimum income must commensurate with the amount of loan applied for.</li> <li>▪ Transaction history of minimum 6 months with the bank</li> </ul>	<ul style="list-style-type: none"> <li>▪ Non-encumbrance certificate</li> <li>▪ CIB report of the borrower</li> <li>▪ Partnership Deed (in case of partnership firm)</li> <li>▪ Memorandum &amp; Articles of Association with certificate of</li> </ul>
	Specialized Loan for Women Entrepreneur	10%-12%	<ul style="list-style-type: none"> <li>▪ Woman entrepreneurs having two years of experience in the same line of business.</li> <li>▪ Monthly cash flow to support proposed loan repayment.</li> <li>▪ Transaction history of minimum 6 months with the bank</li> </ul>	

Non-Bank Financial Institutes	Working capital loan/Overdraft	12%-17%	No difference with bank	No difference with bank
	Term loan	12%-17%		
	Specialized Loan for Women Entrepreneur	10%-12%		
Microfinance Institutes	Micro-enterprise loan/Special loan	19%-27% (reducing balance interest rate)	<ul style="list-style-type: none"> <li>▪ Micro-enterprise capable of graduating from groups, as well as existing entrepreneurs in respective community</li> <li>▪ Personal guarantee from distinguished citizen of the community</li> </ul>	<ul style="list-style-type: none"> <li>▪ 1(one) copy passport size photograph of intending borrower(s) as well as guarantors(s)</li> <li>▪ Valid Trade License</li> <li>▪ Blank cheque minimum of loan amount</li> <li>▪ Land registration is required in some of the MFIs though is not mortgaged</li> </ul>
Cooperatives	Personal loan/business loan	5%-20%	<ul style="list-style-type: none"> <li>▪ Membership in the cooperatives</li> <li>▪ Business goodwill</li> </ul>	No documents required
Local Money Lender	Personal loan	5%-15%/month	<ul style="list-style-type: none"> <li>▪ Personal and business relationship</li> <li>▪ Business goodwill</li> </ul>	No documents required
Finance from Supplier	Trade credit	3%-15%	<ul style="list-style-type: none"> <li>▪ Personal and business relationship</li> <li>▪ Transaction history with supplier</li> <li>▪ Business goodwill</li> </ul>	No documents required

# Annex 5: Examples of Cluster and Value Chain Financing

## **Case 1: Loan Guarantee for Agricultural Cluster and Value Chain Financing**

Agricultural loan guarantees are offered by 3rd parties (private or public) guarantees to enhance the attractiveness of finance by reducing lending risks. Guarantees are normally used in conjunction with other financial instruments, and can be offered by private or public sources to support increased lending to the agricultural sector.

### **Partial Credit Risk Guarantee Facility – Case of the MEDA Project in Ethiopia (this case is adopted from the MEDA Project Documents that was funded by the Government of Canada)**

To build the capacity in the financial sector, MEDA partnered with the Bunna International Bank (hereinafter referred to as 'the Bank') through a shared credit risk partnership, where additional credit was made available for rice and textile value chain actors. The collateral requirements of banks in Ethiopia posed a serious challenge for small entrepreneurs seeking funding for their businesses. In many countries around the world, credit guarantees are implemented as a partial substitute to conventional collateral. Credit guarantees are a relatively new instrument in agricultural development finance. In July 2012, recognizing the need to overcome small businesses' problems in obtaining access to credit, MEDA established this partial credit risk guarantee facility. The aim was to encourage the Bank to lend money to small enterprises by providing guarantees on loans granted by the Bank to the rice and textile sectors in Ethiopia. Through its partial credit guarantee facility, MEDA encouraged the Bank to offer business loans to rice and textile small enterprises in rural areas that commonly lacked access to finance primarily due to inadequate collateral. By covering half of any loans that default, MEDA's credit guarantee boosted financing to small enterprises such as rice processors, textile designers, and exporters, enabling them to create value and demand for rice and textile that ultimately benefited rural farmers and weavers.

MEDA allocated 300,000 CAD for the credit guarantee loans to provide an incentive and comfort to the Bank to grant loans to qualified rice and textile small enterprises, providing additional security coverage for loans that would normally be rejected because of:

- ✓ Lack of acceptable collateral from the qualifying enterprises;
- ✓ Initial lack of technical expertise of the Bank to assess loan applications from the small enterprises;
- ✓ Transaction cost associated with small loans and lack of information on markets; and
- ✓ Risk associated with startups

The credit guarantee aims for the Bank to accept non-traditional collateral to grant loans, which it normally would not accept. The non-traditional collateral are based on criteria such as the borrower's character, credit history and cash flow capacity of the business. Therefore, the credit guarantee effectively reduces the risk exposure to the Bank that is normally associated with providing business loans to collateral-deficient enterprises. It was anticipated that a number of qualified enterprises that previously did not meet the collateral requirements and were not considered by the Bank as legitimate customers, would then be able to access finance.

In countries like Ethiopia where most of the financial intermediaries have been working without guarantee coverage, it is important not to overemphasize the role of guarantee facilities, but to view them in the appropriate context of providing strategic support to sectors that are otherwise neglected or that are in the list of development priorities. Both of these considerations apply to agriculture and agri-business sectors. In order to achieve the purpose of the credit guarantee, MEDA under the EDGET project provided technical support to the Bank in the areas of credit staff capacity building, product development, and credit risk management. In addition, MEDA helped build links between qualifying enterprises and the Bank, and provided information on specific markets in which qualifying enterprises were participating in. Since the launch of the credit guarantee, MEDA supported the Bank to improve its loan appraisal process for small businesses, trained the credit teams in three branch locations, and helped design a portfolio reporting system for the credit guarantee targeted enterprises. Therefore, the

Bank benefited from a strengthened credit processes that enabled MEDA to facilitate access to finance to the target value chains actors.

Since the establishment of this partial credit risk guarantee facility, MEDA and the Bank achieved results in a number of areas, including:

- ✓ Sixteen loans totalling about 290,000 CAD were provided to small rice processors and textile designing enterprises in rural areas with the average loan size of 18,000 CAD. Only one default claim was made by the Bank for 13,000 CAD that made about 4.5 percent of the total disbursements.
- ✓ All of the financed enterprises were running informal businesses and did not have bank accounts. The loans allowed the small enterprises to establish a positive credit and bank history with the formal financial sector.
- ✓ The loans spurred an additional purchase of inputs at a total value of about 273,000 CAD from 990 new rice farmers and weavers in rural locations on a monthly basis.
- ✓ The loans helped boost monthly cash advance provisions from the financed small enterprises to producers at the total amount of approximately 20,500 CAD.
- ✓ The loans helped to start one rice processing facility and one textile design shop.
- ✓ A total of 27 new full time jobs were created by the enterprises in the local communities.

Table 1 below provides details of all loans disbursed and relevant impacts produced by these loans both at the enterprise and rural farmers' levels.

In addition, over the period of this partnership, the Bank benefited from the MEDA technical support that included:

- ✓ Trained ten team members (branch managers and loan officers) in three rural Bank branches on the SME loan application review and appraisal procedures, including assessment of the loan application capacity to repay through the analysis of the financial ratios and cash flow projections and assessment of client's character.
- ✓ Trained two team members of the Bank's Headquarter Credit Department in Addis Ababa who were responsible to provide the managerial oversight to the credit guarantee activities.
- ✓ Developed the portfolio reporting and monitoring systems for the Bank's SME loans in the partnership targeted areas and branches.

### **Case 2: Receivables based Financing (Factoring) (adopted from the book Agricultural Value Chain Finance by Linda Jones and Calvin Miller)**

Factoring is a financial transaction whereby a business sells its accounts receivable or contracts of sales of goods at a discount to a specialized agency, called a factor, who pays the business minus a factor discount and collects the receivables when due. Factoring speeds working capital turnover, credit risk protection, accounts receivable bookkeeping and bill collection services. It is useful for advancing financing for inputs or sales of processed and raw outputs that are sold to reliable buyers.

#### **Factoring in Serbia**

In Serbia, the payments to farmers for the sale of their produce are often delayed. Factoring works well for those needing fast payment. The process is straightforward. The farmer bills its buyers in the usual way except that farmers will be asked to stamp each invoice with a 'notice of assignment' indicating that the invoice has been assigned to a factoring company. This means that the farmer's produce buyer now owes the factoring company the face value of the assigned invoice. The factoring company then advances the farmer's business approximately 75 per cent to 85 per cent of the face value of the invoices. The reserve amount of 15 to 25 per cent that is held back is based on the quality of the accounts rather than on the strength of the farm's business, i.e. the fee fluctuates according to the creditworthiness and performance of the farmer's receivables. The farmer's final payment of the reserve minus the factor fee is received after the buyer pays the factor. The factor fee can be as low as 2 per cent of the invoice amount depending on the level of risk involved. In summary, the benefits of factoring for the farmer are to: 1) improve the cash flow; 2) allow for better financial planning; and 3) allow the farmer to focus on the business and sales rather than collections.

### **Case 3: Warehouse Receipts (adopted from the book Agricultural Value Chain Finance by Roya Tropical Institute)**

Small producers or other value chain enterprises receive a receipt from a certified receipts warehouse that can be used as collateral to access a loan from third party financial institutions against the security

of goods in an independently controlled warehouse. Such systems ensure quality of inventory, and enable sellers to retain outputs and have opportunity to sell for a higher price during the off-season or other later date. Warehouse receipts are an important instrument in value chain financing and it is a part of the broader term of *inventory finance* whereby the inventory of a commodity or asset serves as the guarantee.

### **Field warehousing, India**

The National Bulk Handling Corporation (NBHC) has found that farmers in India realize only about 30–35 per cent value of the value of their produce compared to 65–70 per cent in developed economies. It considers that the agri-produce marketing system in India is inefficient and fragmented and that warehouses, their management, and receipts issued by them do not enjoy market confidence which hinders the development of the industry. Recent initiatives by NBHC to overcome this issue include collateral management agreements with eight leading banks; warehouse receipts that incorporate security features to reduce the risk of forgery; extensive use of information technology in all operations; mobile commodity testing; and in-house commodity protection services. As part of this programme, NBHC field warehousing maintains custody of inventory at specific monitored locations that are connected to the administrative control system, that in turn links to the banks. In order to guarantee the condition and security of stored goods at field warehouses, NBHC obtains regular audit and stock condition intelligence through an in-house team, conducts quality testing, administers security, and manages the health of the stored goods.

### **Case 4: Cluster Based Financing**

**Cluster** based approach to lending is intended to provide a full-service approach to cater to the diverse needs of the MSE sector which may be achieved through extending banking services to recognized MSE **clusters**.

**Funding to develop and grow business-led innovation superclusters in Canada (a new initiative, adopted from <https://www.canada.ca/en/innovation-science-economic-development/programs/small-business-financing-growth/innovation-superclusters/funding-superclusters.html>)**

The Innovation Superclusters Initiative will allocate a small number of high-value, strategic investments in the form of non-repayable contributions to industry-led consortia through a two-phase application process. Contributions will normally be between \$125–\$250 million, for a total of up to \$950 million, and will be matched with private sector investment for maximum impact. The specific number and value of contributions will depend on the applications received.

The Innovation Super Clusters Initiative, launched in May, 2017, is a new and uniquely Canadian initiative. The Government of Canada will work with industry in new ways—through a business-led partnership model—to align the efforts of diverse industries, researchers and intermediary institutions, and build deep, ecosystem-level advantages in regions across Canada. The Innovation Supercluster Initiative will strengthen clusters of existing commercial strength, pulling in a range of highly innovative industries, small and medium-sized enterprises (SMEs) as well as industry-relevant research talent, to create the conditions required to develop a supercluster that reflects Canadian excellence and world-class leadership.

Investments will accelerate commercialization, strengthen capacity in strategic platform technologies, help tackle challenges of importance to industry and take advantage of new opportunities to boost the productivity and competitiveness of Canada's sectors of economic strength.

To accelerate the growth and development of business-led innovation superclusters in Canada, applicants must set out an approach to building a supercluster advantage for their regional innovation ecosystem that translates into new commercial and global opportunities for growth and competitiveness.

The approach should leverage strengths, address gaps, and incent innovation ecosystem players to work together more strategically around [five themes of activity](#) for the collective benefit of the cluster:

- **Technology leadership (mandatory)**—collaborative projects that directly enhance the productivity, performance and competitiveness of member firms

- **Partnerships for scale**—activities serving a target group of cluster firms to enable their growth, including by increasing domestic demand for cluster products and services or by facilitating expansion
- **Diverse and skilled talent pools**—activities enhancing regional labour force skills and capabilities or initiatives addressing industry needs for talent
- **Access to innovation**—investing in and providing access to assets, services or resources that benefit a range of cluster firms over a period of time
- **Global advantage**—activities and initiatives that position the cluster and its strengths as world-leading, enable firms to seize market opportunities, and attract international investments and partnerships

It is expected that companies and other innovation partners will benefit from their participation in activities led by the funded Entity ([including via access to intellectual property generated through collaborative projects](#)), and will participate in the governance of the Entities so that they remain responsive to industry needs and to emerging business opportunities.

#### **Case 5: Special Purpose Vehicle under the Comprehensive Power loom Development Scheme in India**

The Government of India set up the Comprehensive Powerloom Development Scheme (CPDS) in the Bhiwandi and Erode Clusters in the Maharashtra State. The facilities under the scheme included development of core infrastructure (road connectivity, water supply, power supply, sewerage etc.), common facilities (common facility center, warehouse, trade/display centre), HR Development facilities and training centre, weaving support services and commercial area, R&D infrastructure. Under the scheme, the Government of India (Gol) fixed a funding ratio of 40:60; where the Government grants per cluster constitutes a maximum of 40% (with a ceiling of Rs.70 crores). The remaining 60% was provisioned to be raised by a Special Purpose Vehicle (SPV).

Under the scheme, the SPVs were defined as multi stakeholder cluster level legal entity registered under the Companies Act. The SPVs were tasked with ownership, execution and management of the facilities under the project. As per the regulation, the majority of the equity of the SPVs were to be with the weavers of the clusters of their associations/ cooperatives. The remaining stake was expected to be held by strategic investors such as buyers, large scale processing units, banks, financial institutions and state government agencies. The combined stake of these agencies were not to exceed 26% of the total stake. The SPVs were to secure financing for the projects from different government agencies pertinent to the scheme.

In Bangladesh, such SPVs could be set-up to foster cluster development specially through investment on financing infrastructure, common facility centers and training centers which are otherwise not financed in absence of development aid. Unlike facilities established through grant financing without any clear ownership structure, the SPVs provide opportunity to leverage private finance against public finance and develop a viable business model for operating common facilities, warehouse, training and R&D centers for the development of the respective clusters.

**This policy brief has been prepared by extracting the findings of the study on “Cluster and Value Chain Financing in Bangladesh: Current Practices and What Can be Done” conducted by Innovision Consulting Private Limited for the Business Finance for the Poor in Bangladesh (BFP-B) Project funded by the UKaid/ DFID. The views expressed in this policy brief are entirely those of the authors, and do not necessarily reflect the views of BFP-B Project, DFID, Innovision Consulting or any other affiliated organisations.**

#### **About BFP-B Project**

BFP-B is a programme funded by UKaid from the British Government. The Bangladesh Bank is the implementing agency, and the Financial Institutions Division (FID) of the Ministry of Finance, Government of Bangladesh, the executing agency of this programme. Nathan Associates London Ltd. is the management agency. BFP-B is a multifaceted programme, aimed at bringing poor and marginalised people into the formal financial sector and promoting overall inclusive economic growth in Bangladesh. The programme targets ‘access to finance’ for Micro and Small Enterprises (MSEs) that are currently unserved / underserved by the formal financial sector.

#### **BFP-B PARTNERS**

##### **Bangladesh Bank**

Bangladesh Bank, the central bank and apex regulatory body for the country’s monetary and financial system. The key functions of Bangladesh Bank are formulation and implementation of monetary and credit policies, regulation and supervision of banks and non-bank financial institutions, promotion and development of domestic financial markets, management of the country’s international reserves and issuance of currency notes.  
[www.bb.org.bd](http://www.bb.org.bd)

##### **UKaid**

BFP-B Project is funded by UKaid from the UK government through the Department for International Development (DFID) which leads the UK’s work to end extreme poverty that includes ending the need for aid by creating jobs, unlocking the potential of girls and women and helping to save lives when humanitarian emergencies hit. The UK government is currently among the largest bilateral donors to Bangladesh.  
[www.gov.uk](http://www.gov.uk)

##### **Nathan Associates London Ltd.**

Nathan Associates London Ltd. specialises in innovative programmes to reduce poverty, offering expertise in private sector development, trade policy, rural development, agriculture, and economic and financial sector development. Nathan Associates London has been awarded the contract by DFID to deliver technical and financial assistance under the BFP-B Project.  
[www.nathaninc.com](http://www.nathaninc.com)

##### **Oxford Policy Management (OPM)**

Oxford Policy Management (OPM) enables strategic decision-makers to design and implement sustainable solutions for reducing social and economic disadvantage in low- and middle-income countries. OPM has more than 35 years’ experience in over 100 countries.  
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