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Research Study on

Review of SME Credit-related Policies of Bangladesh Bank

Areas of further improvement with a focus on Micro and Small Enterprise (mSE) Finance

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Review of SME Credit-related Policies of Bangladesh Bank
Areas of further improvement with a focus on Micro and Small Enterprise (mSE) Finance

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List of Abbreviations

ACSPD	Agriculture Credit and Special Programmes Department
ADB	Asian Development Bank
ASA	Association for Social Advancement
BASIC	Bangladesh Small Industries and Commerce
BB	Bangladesh Bank
BFP-B	Business Finance for the Poor in Bangladesh
BRAC	Building Resources across Communities (formerly: Bangladesh Rehabilitation Assistance Committee, Bangladesh Rural Advancement Committee
BRPD	Banking Regulation and Policy Department
BSCIC	Bangladesh Small and Cottage Industries Corporation
BURO	Basic Unit for Resources and Opportunities
CAMELS	Capital adequacy, Asset quality, Management, Earnings, Liquidity, Sensitivity
CC	Cash Credit
CDF	Credit Development Forum
CGS	Credit Guarantee Scheme
CIB	Credit Information Bureau
CmSME	Cottage, Micro, Small, and Medium Enterprise
CWS	Credit Wholesaling System
DCCI	Dhaka Chamber of Commerce and Industries
DFID	Department for International Development (UK)
EDP	External Development Partner
EEF	Equity Entrepreneurship Fund
ERG	Economic Research Group
EU	European Union
FGD	Focus Group Discussion
FI	Financial Institution
FID	Financial Inclusion Department
GBCSRD	Green Banking and CSR Department
GOB	Government of Bangladesh
ICICI	Industrial Credit and Investment Corporation of India
ICT	Information and Communications Technology
IEG	Independent Evaluation Group
IFC	International Finance Corporation
ICT	Information & Communication Technology
IGA	Income-generating activity
InM	Institute of Microfinance
INSPIRED	Integrated Support to Poverty and Inequality Reduction through Enterprise Development
IP	Industrial Policy
KYC	Know-Your-Customer
mE	Micro Enterprise
MFI	Microfinance Institution

MOF	Ministry of Finance
MOI	Ministry of Industries
MRA	Microcredit Regulatory Authority
mSE	Micro- and Small-sized Enterprise
mSME	Micro, Small-, and Medium-sized Enterprise
NBFI	Non-bank Financial Institution
NCB	Nationalised Commercial Bank
NGO	Non-governmental Organisation
NPL	Non-performing Loan
NPS	National Payment Switch
OECD	Organisation for Economic Co-operation and Development
OSMEP	Office of Small and Medium Enterprise Promotion (Thailand)
PAC	Policy Advisory Committee
PCB	Private Commercial Bank
PKSF	Palli Karma-Sahayak Foundation
PTM	Project Team Management
RFP	Request for Proposal
SE	Small Enterprise
SEC	Bangladesh Securities and Exchange Commission
SFD	Sustainable Finance Department
SMI	Survey of Manufacturing Industries
SME	Small- and Medium-sized Enterprise
SMECORP	SME Corporation (Malaysia)
SMEDS	Small and Medium Enterprise Development Strategy
SMEF	Small and Medium Enterprise Foundation
SMESPD	Small and Medium Enterprises and Special Programmes Division
SPRING	The Standards, Productivity, and Innovation Board of Singapore
TMSS	Thengamara Mohila Sabuj Sangha
TOR	Terms of Reference
WB	World Bank
WE	Women Entrepreneur

Foreword

Bangladesh embarked upon small and medium enterprise (SME) policy during 2003-04. The Bangladesh Bank (BB) had formulated guidelines for Small Enterprise (SE) financing by 2004, and the Ministry of Industries (MOI) had the Policy Strategies for development of SMEs in print by 2005. The modality of resource transfers under the SME Development Project (SMEDP) of the Asian Development Bank (ADB) had got entangled with the larger debate between finance though banks and technology transfers through MOI or agencies affiliated with it. The urge to identify beneficiary enterprises led BB to define various segments of enterprises in 2007, which were subsequently notified via ACSPD Circular of 2008. With the Industrial Policy (IP) 2010 spelling out the definitions, BB chose to align its definitions accordingly to guide SME-targeted lending activities of participating banks and NBFIs. The IP 2016 adapted a new set of definitions for CmSMEs, following which a SME Development Strategy is under preparation. Bangladesh Bank (BB) is expected to revise its SME financing policy and guidelines accordingly. BB has also extended supports to the Microcredit Regulatory Authority (MRA) in the latter's efforts to enable microcredit organisation in the country to better engage in financing micro-enterprises (mEs). In such a changing setting, Business Finance for the Poor in Bangladesh (BFP-B) programme, funded by UK-Aid and implemented by the Bangladesh Bank, has been operating since 2013-14 to foster increased access to finance for Bangladesh's micro- and small enterprises (mSEs). The Policy component of the BFP-B programme, which aims at facilitating enabling regulatory environment for the mSE sector in Bangladesh and for increasing financial inclusion for small business, commissioned the present study. The study is meant to review Bangladesh Bank Policies on micro, small and medium enterprise (mSME) financing and make recommendations for improved access to finance for micro and small enterprises, to understand the stakeholders' views on current SME Policy of BB and recommend areas of further improvement. Economic Research Group (ERG), a not-for-profit research organisation, operating out of Bangladesh, was awarded the contract in early May 2016.

A group of ERG researchers, along with inputs from several consultants with direct experiences in working with SME lending, undertook the exercise. It involved compilation of all relevant documents, reports and circulars, and detail review of those. Lists were prepared of stakeholders from demand and supply sides of the market, as well as from regulators, policymakers and academia. Beside interviews of individuals, consultations were mostly done in small groups. Several FGDs were conducted outside Dhaka, of which Bogra, Narsingdi and Bhairab are noteworthy. The research team developed an analytical framework to place all the information in a single comprehensive canvass for reasoned understanding of the issues and contextualise the recommendations. A policy brief in English and another in Bangla have been separately prepared for circulation, which substitutes an executive summary for this report.

The team expresses its gratitude for valuable comments from several anonymous reviewers, to the members of the Working Committee and the Policy Advisory Committee for sparing their valuable time to hear presentations and comment on earlier drafts, and to the BFP-B team and Nathan Associated Ltd. (London) for financial supports. Insights provided in this report would not have been possible without long consultation hours spared by numerous bankers, business persons, researchers/consultants, government officials and policymakers the team remains grateful to all.

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Review of Bangladesh Bank Policies on mSME Financing:
Recommendations for improving access to finance for micro and small enterprises (mSE)

I. Introduction

I.1 Background

Drafting of the National SME Development Strategy 2016-20 followed the adoption of Bangladesh's Industrial Policy (IP) 2016, and the timing coincided with commissioning of the present study. Note also that we use 'SME' as a buzzword, whose content is perceived to have undergone changes over the years. While all documents on IP continue to interpret SMEs as 'small and medium enterprises', there appears to have been gradual shift in emphasis towards small and micro enterprises (mEs) in practice. The policy document recognises the roles of the SME Foundation (SMEF), which largely addresses the small enterprises (SE). The shift from medium and small to small and micro is also visible amongst financing institutions, especially in multilateral lending agency (such as, the Asian Development Bank - ADB) and in Bangladesh Bank's (BB) SME financing strategy. BB has also been extending supports to the Microcredit Regulatory Authority (MRA), in latter's efforts to enable microcredit organisation in the country to engage in financing mEs. In such a changing setting, Business Finance for the Poor in Bangladesh (BFP-B) programme, funded by UK-Aid and implemented by the Bangladesh Bank, has been operating since 2013-14 to foster increased access to finance for Bangladesh's micro- and small enterprises (mSEs)[1]. The Policy component of the BFP-B programme, which aims at facilitating enabling regulatory environment for the mSE sector in Bangladesh and for increasing financial inclusion for small business, commissioned the present study. The study is meant to review Bangladesh Bank Policies on micro, small and medium enterprise (mSME) financing and make recommendations for improved access to finance for micro and small enterprises[2], to understand the stakeholders' views on current SME Policy of BB and recommend areas of further improvement. Economic Research Group (ERG), a not-for-profit research organisation, operating out of Bangladesh, was awarded the contract in early May 2016.[3]

I.2 Study Objectives

The overall objectives of this study are the followings:

- To understand the stakeholder perspectives and experience of using the mSME and SME Policy of BB;

[1] BFP-B is reported to have commenced its work in 2013 though it took a while to sign an MOU for the undertaking.
[2] See the Terms of Reference attached in Annex 1. The working title of the project had been "Review the SME Credit-related Policies of Bangladesh Bank: Identify areas of further improvement by focusing on MSE finance". An alternative was suggested at the RFP stage, and subsequently, the current formulation is proposed to reflect the comments made on the draft Inception Report. The latter was submitted by ERG on 25 May 2016. We purposively use lower case 'm' for micro, to distinguish it from capital 'M' used for medium.
[3] Some of the activities for the study were undertaken long before the Inception Report was formally accepted in early July 2016, and the first draft report was submitted on 7 September 2016. Based on reviews/comments received from the Nathan Associates on 1 October 2016, the paper has been revised. Subsequently, two presentations were made, to Working Committee and to the Policy Advisory Committee. This final version addresses all concerns raised during those meetings.

- Recommend suitable definition of mSMEs that may contribute towards formulation of SME Strategy document of the Ministry of Industry[4], and MRA's attempt to defining microenterprises (mEs);
- Appraise the feasibility of developing two separate policies for financing of different enterprise segments, say, mSEs and medium enterprises (MEs), or, mEs and SMEs; and
- Recommend further improvements of Bangladesh Bank's current SME Policy, which is presumed to include micro enterprises as well.

I.3 Study methods

Unlike academic undertakings that dig into data with fancy tools to verify hypotheses and/or delve into mathematics of decision-making of multiple agents and their outcomes in a (financial) market, the present study is pitched at a pragmatic level. It raises a series of inter-linked questions: (i) what are SMEs? (definition); (ii) what have been the key elements of Bangladesh Bank's SME financing policies, including a question on what is meant by 'policies'? (review), (iii) what have the experiences been in translating those policies into practice by different stakeholders, including those who had received (or, were keen to receive)? (Stakeholders' view), (iv) given various segments within the loosely identified SMEs (CmSMEs)[5], would it be more appropriate to have separate (segment-specific) policies, and institutional arrangements? (consultations and analytical review, as well as summary of practices in other countries), and (v) given the government's industrial policy and the need for a well-functioning financial market, what changes or amendments need to be made in BB's SME Credit Policy?

The methods to arrive at answers to the above-mentioned questions involved an iterative process of desk reviews (of reports, academic papers, circulars and policy documents), cross-checking with available sources of data (including analyses of data where availability permitted), and consultations ranging from meeting individuals, talking to workers and management at work places, and focused group discussion (FGD). A broad list of stakeholders was agreed upon during the inception phase, and it included representations from regulators and policymakers, supply-side actors (including those who demanded fund from one source and supplied at lower tiers in the financial market), mSEs and their associations who represent the demand side of the market, several external development partners, and the academia-researchers and consultants, who have long been working in the field of SMEs and their financing. The complete list is attached as Annex 2 at the end of this report.

The team of researchers had reviewed a wide range of literature, often digging deep into specific issues. None of those were meant to be summarised, and relevant ones are referred to only when a related issue is discussed in this report. While the list of references is included at the end, it is

[4] The Terms of Reference mentions of 'unified' definition, which may be interpreted to imply a single set of definitions applicable to all sub-sectors. Based on exchanges with the consultant responsible for drafting the SME strategy paper, it is proposed that a common set of definitions should be sought, without restricting the exercise to finding a single definition (i.e., on thresholds for, say, small) for all segments of enterprises. The latter is recognised in policy documents of recent vintage where cut-offs vary across manufacturing, service and trading activities.

[5] CmSME stands for Cottage, Micro, Small and Medium enterprises, which is noted in the Industrial Policy, a departure from past practices of having cottage and handloom lumped into one, or cottage and small shown under one head (as in BSCIC, Bangladesh Small & Cottage Industries Corporation).

worth mentioning that the following policy documents and Bangladesh Bank circulars were considered important in defining the core content of the policies. A selected few are listed in Table 1.

Table 1: Selected List of Policy Documents and Report Reviewed

Strategic Plan (2010-2014), Bangladesh Bank
Strategic Plan (2015-2019), Bangladesh Bank
SME Policy Guidelines and SME related circulars, Bangladesh Bank
SME Credit Policies and Programmes (2010), Bangladesh Bank
Microcredit Regulatory Authority Rules (2010), Bangladesh Bank
National Industry Policy (2016), Ministry of Industry
National SME Development Strategy, 2016-20, Ministry of Industries
National Handicraft Policy, Ministry of Industry
Policy Strategies for Development of Small & Medium Enterprises (SME), 2005, SME Cell, Ministry of Industries
Memorandum and Articles of Association, SME Foundation
Chapter-8, 7th Five-Year Plan, Ministry of Planning

Note: For a complete list of articles, reports, documents reviewed, see References.
Master Circulars of BB with directives and guidelines have not been discussed elsewhere.

I.4 Brief outline of the report

The report is organised to assist policymakers in the fields of financing micro and small enterprises. In particular, we have the Bangladesh Bank (BB) and the Banking Division of the Ministry of Finance (MOF) in mind, both of whom would be collaborating with the Ministry of Industries (MOI) and other relevant line ministries and departments to realise broader goals of the Government to promote inclusive growth. The purposes of targeting a sector ('enterprises') and identifying segments within it (such as, micro and small enterprises) for preferential treatments are closely tied with definitions. In addition, there is close correspondence between the instruments used for transfer of benefits, organisational vehicles used and efficacy of targeting.[6] The general conceptual framework, with few unavoidable abstractions, is presented in the following section (II). A glossary with analytical/technical terms and their relations is attached in Annex 4 for better understanding of the policy canvass. Section III presents basic features of current policies and practices. Though historical perspectives were unavoidable in both the sections (II and III), the details on those are relegated to Annex 4. Section IV draws

[6] There is lot to learn from our experiences in targeting poor and poverty, particularly, in the fields of food and credit distributions. One may like to consult literature on targeting social transfers as well. See Devereux *et al* (2015).

upon the consultation sessions with various groups of stakeholders, as well as the researchers' interpretation of available evidence, to summarize the experiences from implementing past BB policies of SME financing. The purpose is to draw key lessons that may guide us into defining future actions. The latter is undertaken in Section V, which presents a number of alternative settings, including that posited in the draft SME development framework of the Ministry of Industries. The section also discusses in details the issues on definition, and possible needs for availing alternative organisational vehicles to reach out to various segments of enterprises in Bangladesh. As noted before, the details are relegated to annexes, and the main body of the report is kept brief.

II. Detour on Concepts and Analytical Framework[7]

There are three broad themes raised in this section:

(i) Contextualising SMEs in terms of purposes so that several shades may be differentiated. Perspectives on definitions are presumed to have close correspondence to those shades.

(ii) The various policy instruments that are at the discretion of Bangladesh Bank; and the various ways these are announced, such as, through Policy, Guidelines, Directives and Regulations. Distinction between financial and non-financial measures is emphasised in discussing various policies.

(iii) The organisational elements in the financial canvass, which have potentials to mobilise finance for SMEs, and the segment within which the scope of the present exercise is confined.

II.1 Perspectives on SMEs and Rationale for SME-focused Financing

The literatures on SME unanimously agree that there is no unanimity in our understanding of SME. The literature reviewed during the course of current exercise reveals of at least four different takes on SMEs, which are worth noting in order to contextualise SME financing and the role of a regulator (such as, the Bangladesh Bank). *First*, SMEs are a clientele group who could not be reached out with the financial products and their delivery mechanisms traditionally practised by the commercial banks. Often, the latter associates the potential client on the fringe with small loan sizes, peculiarities in time-path of demand and repayment, and with those having legal entitlements perceived by lending community inadequate as securities to guard against (lenders') risks. It is perceived that certain initial supports, on both demand and supply sides of the market, will enable the banks to break the inertia and engage in a sustained path of win-win exchange. The *second* is from the domain of public policy, where redistributive justice is perceived to be associated with provisioning of targeted assistance to the 'smaller' (and poorer) entities. The *third* is a technocratic-economic perspective that takes cognisance of inter-industry linkages and presumes that failure to perform among some of the weaker segments in the links may lead to greater loss in the economy. Thus, reaching out to those segments with special efforts is justified on ground of aggregate return to the economy. There is a *fourth* perspective, more appropriate in the context of Bangladesh, which we view as 'institutional'. The country has

[7] Much of the content in this section, even though couched under methodology, evolved out of iterative consultations and review of reports and documents.

a rich history in microcredit, and many of the microcredit (microfinance) institutions[8] graduated to engage in multiple activities and some may comfortably lend-out large loans. In the context of SME discourse, there are four distinct aspects to this institutional transformation, which remain to be comprehensively addressed by appropriate legal framework. These include, (i) increase in loan sizes, irrespective of uses, due to both changes in nominal value and growth in client group with long history of borrowing from same source; (ii) gradual shift in portfolio from home-based income-generating activities (IGAs) to cottage and microenterprises; (iii) some of the MFIs borrow from commercial banks and act as intermediaries by lending to their borrowers[9]; and (iv) some of the NGO/MFIs have also engaged in enterprise-level activities outside finance, and several of them may be 'small' to 'medium' under current definition. Beyond the four perspectives mentioned, there is also the case of start-ups, or, the "Startupreneurs", a term recently coined for new entrepreneurs[10]. In the absence of prior information to assess risks in lending to Startupreneurs, the banks as well as the non-bank financial institutions (NBFIs) have generally avoided them. It has largely been the venture capital firms who dominate such lending. Since functioning of venture capital firms are within the jurisdiction of SEC, the links between SMEs and 'start-ups' have hardly received any attention.

Though little mentioned, the effort for meticulous definitions arises where targeting and monitoring are involved. Past initiatives to define 'poor', 'food-insecure' households, or 'under-nourished' children were tied with targeting as well as monitoring. It is therefore expected that differences in one's position vis-à-vis the enterprises influence the way one wants to define one or the other segment among enterprises. There are at least two groups of stakeholders having exclusive focus on financial lending – the commercial banks (and NBFIs) and several (all credit) MFIs. The banks, with traditional banking practices, uphold the first perspective mentioned above. For them, moving from large loans and enterprises in the formal sector to borrowers of small loans having less organised balance sheet of assets and liabilities, involves declining net pay-off. Reverse is the case for MFIs, which have grown beyond their original mandates (Figure 1)[11]. Both stakeholders however find loan size as an important variable to identify various segments of their client groups. The technocrat-economic perspective, often manifested in the position of the Ministry of Industries and SMEF, would prefer to identify 'economic sector's, and fit those with notions of micro and small, as propagated by lending agencies.[12] There are however actors on both sides, finance and industry, who appreciate the need to tie the two ends in effective manner. Examples may include, PKSF, SMEF and a handful of SME wings of commercial banks (e.g., BRAC bank). The subtle difference one observes is as follows: those

[8]One may make subtle difference between the two terms by describing credit to be specifically dealing with lending and borrowing, while finance is more generally about managing assets. However, both these terms can be used to describe a purchase in which one promises to pay for it over time – 'to finance a purchase is to buy it "on credit", and in this usage, they are synonymous'. To be in line with current practices in the literature, we use the term MFI. We cite relevance of MFIs in the context of SME discourse, but do not probe into policies of MRA that regulates the MFI sector since the scope is confined to BB policies.

[9] One may consider it as one manifestation of 'agent banking'.

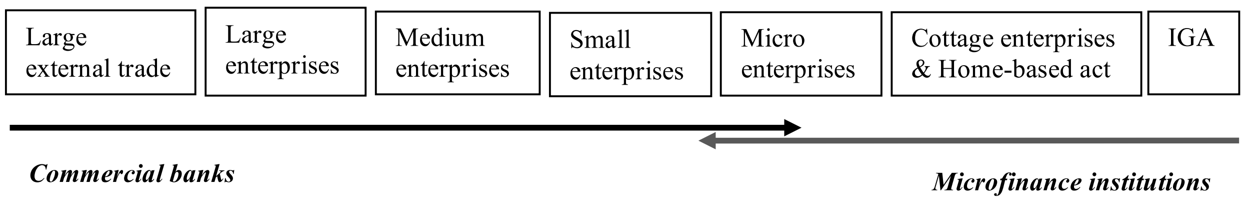
[10] See, Halima Sadia's write-up, 'The Chronicles of Bangladeshi Startupreneurs', in *The Daily Star*, 2 September 2016.

[11] The MFIs, rather ironically, ought to lower interest rate in order to expand into upper stratum. There is also the possibility of reduced access to 'poverty fund', all of which may effectively imply declining net payoffs. Further discussion is made in Section V.

[12] Earlier works on SMEs looked into specific sectors that were deemed to deserve privileged attention.

coming from banking and finance would like to ensure healthy returns with reduced risk to their financial engagement while the promoters of enterprises (industry) appreciate the need for finance without necessarily tying those to banking only.

Figure 1: Development of financial institutions from two ends of the 'enterprise' spectrum



Finally, there are policymakers and regulators, including the Ministry of Finance and the Bangladesh Bank, who have significant influence on mSME sector. Though public policies, particularly on distribution, are articulated in Plan documents prepared at the Ministry of Planning, the latter apparently has no direct influence on regulations and policy implementations in the financial markets. The Industrial Policy under the Ministry of Industries provides the overall guidelines, but the Ministry may only contribute indirectly to design and implementation of financial policies through coordination committees. For the purpose of the study, we will therefore consider higher management of Bangladesh Bank and the Banking Division of the Ministry of Finance to be prime movers – in translating policies of other ministries (Industry in our case) as well as for regulating the banking sector to ensure its contributions to growth of the real sector of the economy.

In summary, from the perspective of the financial institutions, SMEs embody a client group of businesses ('entrepreneurs') who are at the fringe of normal banking operations, and reaching out to them often require incentives. Policymakers keen on promoting industrial growth would like to see more resources go into specific sectors; and would be willing to package those under SMEs if better resource inflows are assured. Finally, one expects the regulators to ensure that the financial sector contributes to the growth of the real economy; and that the financial health and governance of the financial institutions are not adversely affected while they facilitate government's development objective of inclusive growth. It is in the latter context where concerns with SMEs arise, though there may be concerns with smaller/weaker players in each economic sector to ensure universal access to finance and for growth with equity.

II.2 Policy, targeted transfers and implementation designs

While the umbrella policy for SMEs is derived from the Industrial Policy[13] and the SME development strategy (to be finalised), it is the Bangladesh Bank, along with the Ministry of Finance, who formulates the relevant financing 'policies' and oversees their implementation. Clearly, preferences of funding agencies, choice of target, and of financial and non-financial

[13] While this has been the trend, SMEs cut across jurisdictions of several line ministries, such as, commerce, ICT, Agriculture, Youth and Women Affairs.

services/benefits along with delivery mechanisms, are all inter-linked. This sub-section outlines the broad canvass for better understanding of the lessons to be drawn and the multi-dimensionality of changes proposed at the end of this report. It also takes cue from the earlier discussion, to link purpose, choice of targets and definitions (of SMEs), choice of policy instruments and organisational vehicles, and the overall efficacy of policies in terms of strengthening or distorting a financial market and its governance. The last two of the three issues identified at the beginning of subsection II.1 are discussed below separately.

II.2.1 Policy, Guidelines, Directives and Regulations

BB's documents pertaining to SME financing over the years took different names, such as, policy frameworks, policy guidelines, prudential guidelines, Circular, Master Circular and Circular Letter.[14] The themes, covered in those documents, range from expression of general intent, general modality of implementation, to directives for achieving specific targets expressed in numerical figures. The study team reviewed most of the items addressing SME financing, a list of specifics, grouped under several 'policy types', is presented in Annex 3 (Table A.3.1). Amidst this apparent mixed bundle of issues and document types, which have multiple overlaps, the research team chose to search for a consistent structure in the understanding amongst practitioners at various levels through a dialogical method. This section summarizes the elements of consensus.

At the onset, we distinguish between issues that are generic to general operations of the banks and non-bank financial institutions (NBFIs) from those related to SME financing. The policy document offers a flavour of the broader perspective of what is to be done and the ulterior goal to be achieved by doing so. Since it is decreed by a central authority, a policy has legal bindings. In other words, a policy may often be developed with positive externalities in mind, or in order to reach some socially desirable state, which may not have been, otherwise, possible when individuals act out of their self-interest. Examples of policies include: Loan rescheduling policy, underwriting policy/approval, loan write-off policy, customer on-boarding policy, know-your-customer (KYC) policy (which has been, subsequently, included under anti-money laundering act), etc.

Guidelines cover dos and don'ts of the trade. It can be either (a) a starter's-kit for institutions new to the field or a run-down of good practices to have, or (b) encouragement of practices that lead to a desirable goal. Guidelines can be seen as 'soft' policies, because the institutions are not bound to follow the guidelines. Positive incentives may be awarded, but institutions cannot be punished for non-compliance. Examples include school banking guidelines, guidelines for credit-risk management for banks, etc. If the guidelines are of type (b), over time, these may get fine-tuned and take the form of a consolidated policy guideline, similar to a formal declaration (i.e. formulation of a policy) meant to reach a certain goal.

[14] At the national level, Policy Papers are followed up by Plan of Actions, submission and inclusion in ADP/MTBF, and approval of Operational Manual, before the activities are brought under the jurisdiction of Implementing Agencies. In this case, such a sequence of activities precedes the undertaking by a central bank, other than, possibly, the operational manual.

At this point, these policy guidelines, which become a part of the policy document, provide instructions on how to achieve said goal, as it explains to the concerned parties specific behaviour to adopt and actions to take. A directive such as 'x% has to be lent to W' is an example of a policy guideline. The specific steps which the central authority wants the financial institutions to take/follow, in order to ensure realisation of policy objectives, can be termed as regulations. These involve mandatory adoption of behaviour and undertaking of actions as stated. Organisations may be awarded positive incentives for extraordinary performance in line with achieving the goal, though they may not be entitled. On the other hand, violation of compliance is met with punishment. Regulations are in place to ensure that policy guidelines are followed.

II.2.2 Multiple actors in the Financial Market and the Scope of the work

Figure 2, along with the footnote, outlines the broader framework within which Bangladesh Bank's SME credit policy, guidelines and regulations may be assessed and recommendations for future may be contextualised.

It needs mentioning that the outline in Figure 2 was developed through inductions of various information obtained during numerous consultation sessions, and from prior knowledge of the researchers regarding processes involved. Given the history of SME financing in Bangladesh, and the way BB's role has evolved over time, it is imperative that the focus remains largely on the right side of the Figure, with emphasis on the bottom part.[15] Even though a host of issues are addressed in BB's directives to the banks and NBFIs[16], the important ones on SME financing are the followings:

- Refinancing;
- Loan provisions,
- Incentives tied to share of loan disbursement to SMEs (e.g., credit rating),
- Non-financial services, such as, dedicated desks, SME centres or SME Branch,
- Linking financial services with providers of non-financial services.

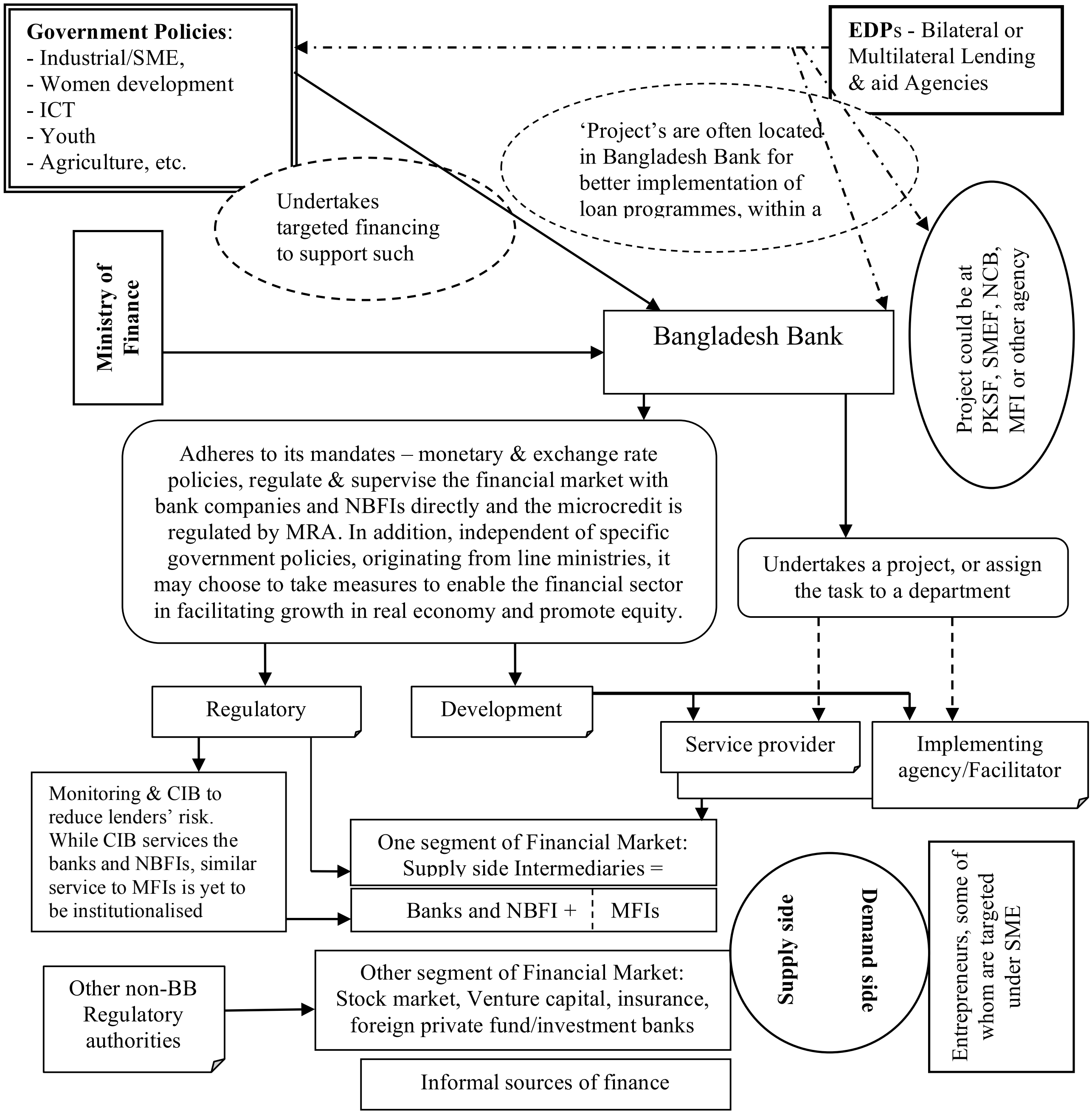
Generally, these policies will be looked into with a view to assess,

- If the incentives (or, penalties) could realise the policy objective of increasing access to finance by SMEs;
- To what extent, the interventions (no matter how well-meaning those may have been) distorted the financial market and practices of the financial institutions, and thereby, hindering the contribution of financial intermediaries towards growth of the real economy; and
- Upon understanding the relative roles of financial and non-financial measures to promote micro and small enterprises, arrive at desired roles of Bangladesh Bank and its policies.

[15] However, policies are effective only when those account for the responses to policies, it is important to recognise the multiple roles of BB (as regulator, potential contributor to development through financial markets, implementing agency and occasionally, service provider), some of which may run into conflicts. The broader structure of governance has not been addressed in this report.

[16] Table A.3.1 mentions of delivery mechanism, general guidelines, such general restrictions as minimum share in disbursement, media coverage and non-financial incentives, non-financial services such as dedicated desks, linking SME financing with other objectives on ICT or women entrepreneurship, loan terms & conditions, incentives through refinancing and favourable loan provision, improved supervision, etc.

Figure 2: Contextualising BB's 'SME Credit Policy' within a larger canvass of actors



Note: In addition, there are three agencies which are to be accounted for: (i) NCBs under the supervision of Banking Division of M/O Finance, and administering separate microcredit and SME credit programmes; (ii) SMEF under the Ministry of Industry, focused on enterprises, often linking those with sources of fund, including commercial banks; and (iii) PKSF, a credit wholesaling agency, formally under the Ministry of Finance, and keen on tying their borrowers with technology and marketing agencies in order to reduce risk in their lending.

III. Overview of current Policies and Practices

The draft SME development strategy paper (MOI 2016) notes that Bangladesh Bank made progresses in motivating commercial banks to serve SMEs through directed lending programs and financial products. The services identified include:

- Providing refinance to accredited banks and NBFIs by using its own fund and financial support (as loans) of external development partners/lending agencies,[17],
- Opening of Dedicated Desk and SME Service Centre in the banks and special services for the women entrepreneurs,
- Establishment of a dedicated department named 'SME and Special Programs Department' to formulate policy, facilitate credits and monitor the development of small and medium entrepreneurship.
- Setting indicative targets for SME loan disbursement for a year and is involved closely with the banks and financial institutions to achieve it.

The above clearly tally with the ones listed in the preceding section, other than the need to disaggregate the financial incentives further into refinancing (which is addressed above) and favourable loan provisioning for SME lending. Basic information on these is summarised in Boxes 1 to 3, separately dealing with loan provision, refinance and SME branch/centres.

A brief history of SME banking in Bangladesh, along with evolution of policies and governance structure, is presented in Annex 4. It is worth noting that SME-related policies are now in the domain of SME & Special Programme Department (SMESPD), fragmented from the newly emerging broader theme of financial inclusion, as well as from sustainable development[18]. More importantly, the erstwhile core policy unit, BRPD, engages on SME issues only on a horizontal plane, coordinated by the Project Team Management (PMT). Several tables in Annex 5 list all the circulars having relevance for SME financing; and currently, SMESPD Master Circular No. 1, dated 07.01.2016 overwrites all previous ones. The loan provision facility, provided in BRPD Circular No. 14, dated 23 September 2012, however still stands.

Following the discussion allured to in II.2.1, one may characterise the SME-related BB 'policies' at various tiers. At a more general first level, the followings may be mentioned:

1. Following the articulation in the Industrial Policy, SME is a buzzword that refers to cottage, micro, small and medium enterprises (CmSME).[19]
2. Following the Industrial Policy, the segments within CmSME are distinguished by either the replacement value of fixed assets (other than land and factory building), or, number of labourers/workers employed. Details on the definitions and how those evolved over the years are summarised in Table A.5.5 and A.5.1 in Annex 5.
3. The 'enterprise' part of SME is not explicitly defined in the Industrial Policies. Such terms surface only as 'industry/entrepreneur'. Once the alignment was established in IP2010, for all practical purposes, BB's circulars on defining cottage, micro, small and

[17] The draft SME strategy paper carried the following statement, 'Credit wholesaling by using the grants received from different development partners' (p. 35). This was later corrected by the SMESPD.
[18] There are two new departments by those names. See, Tables A.5.2 and A.5.3 in Annex 5.
[19] We use the term CmSME for the whole range of enterprises, though most references in this report are to mSME.

medium enterprises have been extensions of Industrial Policy. SMESPD Master Circular No.1 of 2016, which preceded the approval of IP2016, adheres to the criteria stipulated in IP2010, and differentiates across manufacturing, service and trading, and have different cut-offs to distinguish across micro, small and medium. There has been a clear departure in emphasis in the Industrial Policy 2016. The latter defines small and medium separately for manufacturing and service, has cut-offs for a separate definition under (micro) service and another definition for general category under micro. There is however no sector-specific definition under cottage.[20]

4. Almost all sectors of mSME, except M, have been tagged as preferential sectors. The 'preferential sector' tag does not offer any tangible benefit except that Banks and FIs have been advised to treat their loan application on a priority basis.

At a second level, SME-related BB policies include the followings:

5. BB's SME financing policy chooses commercial banks and NBFIs as intermediaries through whom benefits are expected to be transmitted to the sector. In other words, incentives are provided to these financial institutions so that they engage in lending to SMEs, presumably in favourable terms and conditions.
6. Though outside the direct jurisdiction of SMESPD, BB can promote cottage and micro enterprise financing through policies of MRA, which in reality is closely associated with BB. To our knowledge, there is no unified policy.
7. As shown in Figure 2, there are funds channelled through projects – SMEF, PKSF, or through project offices funded by EDPs, some of which involve commercial banks as well. This segment, to our knowledge, remains outside the purview of BB's SME financing policy.
8. Several line ministries also administer credit programs aimed at micro enterprises, which also appear to be outside the purview of MRA or BB/SMESPD policies.

Policies at the implementation level had already been discussed. Some of those are highlighted with specifics.

9. Refinancing fund for lending to SME loans to women entrepreneurs[21] restricts lending agencies from lending at interest rates above10%. In all other cases of refinance under SME financing, the circulars explicitly mention of availing market (or, mutually agreed) interest rates. Refinance is not available to Banks having NPL exceed 10%.
10. The differential loan provision exists since 2012. It is 0.25% for unclassified SME loans, lot lower than 1% applicable for general unclassified loans.
11. Share of SME loans is now included in CAMELS rating, though the weight is as low as 1% in total rating.

[20] Exchanges since the submission of the revised report reveal that BB had extended classification of trading sector and BB will soon issue a new circular defining cottage, micro, small and medium on the basis of IP2016.

[21] WE sub-segment has received highest attention in BB policy, rightly aligned with national focus on gender balance and bring the larger segment of the population under income earning activities. This is the only segment where collateral-free loan has been permitted.

Box 1: Use of Provisioning for Promoting Lending to SMEs, from Master Circular 2012

BRPD Circular No.14, 23 September 2012

4. Maintenance of Provision:
a) General Provision: Banks will be required to maintain General Provision in the following way:

(1) @ 0.25% against all unclassified loans of Small and Medium Enterprise (SME) as defined by the SME & Special Programmes Department of Bangladesh Bank from time to time and @ 1% against all unclassified loans (other than loans under Consumer Financing, Loans to Brokerage House, Merchant Banks, Stock dealers etc., Special Mention Account as well as SME Financing.)
(2) @ 5% on the unclassified amount for Consumer Financing whereas it has to be maintained @ 2% on the unclassified amount for (i) Housing Finance and (ii) Loans for Professionals to set up business under Consumer Financing Scheme.

Box 2: Refinancing Fund for lending to SMEs

ACSPD Circular 01 Dated May 02, 2004 on SME Re-financing BB Fund

Bangladesh Bank issued a circular to commercial banks and financial institutions to launch its refinance fund of Tk. 300 crore for the development of new entrepreneurs. The refinancing facility allowed the Banks and financial institutions to receive 100% refinance against disbursement of both working capital and term loans to the small enterprise sector; the loan amount ranging from Tk. 2 lac to Tk. 50 lac. Even though the expectation was to facilitate lending at lower interest rates, the circulars allowed lending banks or financial institutions to apply their own interest rate on the loans made to the ultimate borrowers.
The facility was not applicable for personal or consumer loans, and a bank was eligible to avail it only if the share of classified loan was less than 10%.

ACSPD Circular Letter 03 dated June 12, 2008 raised the fund amount from Tk. 300 crore to Tk. 500 crore.

Box 3: SME Service Centres

BRPD Circular letter No.-06, Dated May 04, 2008 on Introduction of SME Service Centres for loan disbursement and recovery in the Small and Medium Enterprise (SME) sector

With a view to increase credit flow to the SME sector and increase employment opportunities in distant areas, Bangladesh Bank decided in principle to accord permission for opening SME Service Centres for all scheduled banks. These Service Centres would be allowed to perform the following functions:-

1. The SME Service Centres will render banking services only for receiving application, disbursement, monitoring and recovery of loan to SME sector.
2. The SME Service Centres will be allowed to receive foreign remittances and deliver /hand over the same in domestic currency to the payees concerned.
3. The SME Service Centres will be allowed to open a separate desk in order to prioritize the women entrepreneurs involved in the promotion of Small and Medium Enterprise (SME) sector.

1. Opening of SME service centres were encouraged during 2008-10, and no new approval is reportedly being given now. There are also dedicated desks, particularly for women.
2. Of total SME loans disbursed, the lending agencies are instructed to ensure a minimum of 40% for small enterprises. Similarly, a minimum of 15% is set for women entrepreneurs. For all practical purpose, these remain guidelines.

IV. Experiences of Past and On-going Practices in SME Financing
- Summary lessons drawn from interviews, FGDs and limited data

IV.1 Findings from FGDs and Interviews

The study team engaged extensively with stakeholders of diverse backgrounds, having a common denominator in their familiarity with SME issues. While few have been left out from the earlier list, it had been largely compensated by inclusion of several important individuals. Beside group-based and individual level consultations in Dhaka (see, Annex 2), members of the study team had visited Sirajganj, Bogra, Narsingdi and Bhairab. Of several factory premises visited, there were shoe manufacturing, plastic products, yarn & dyeing, jute bags using power looms, etc. Broad observations and findings are organised thematically.

IV.1.1 Supply Side

1. Our attempt to construct what constitutes BB's 'SME financing policy' had been raised earlier. From the practitioners' perspectives, be they staff of implementing commercial banks or the executives at BB, SMESPD Master Circular No. 1 (dated 07.01.2016) is identified as the key document. The BB officials however recognise two important umbrella frameworks which define the parameters of BB's general SME financing policy. These are, (i) the Industrial Policy of the Government, and (ii) operational guidelines in project documents of lending/aid agencies, when financing is done under such project arrangement (please see Figure 2).

2. The SME financing policy and BB's perseverance forced the banking community, particularly those in private banks with grooming in foreign banks and having knowledge of segment-wise business management, to extend their net to borrowers of smaller amount, and to enterprises having insufficient books of accounts. The fast expansion of the banking industry with new banks entering the market also forced them to look beyond the traditional clients in import-export business, and subsequently, beyond large industrial groups. There are however apprehensions that the traditional commercial banks, with their institutional culture and the prevailing package of lending (interest) rates, may not be keen to stretch their nets much beyond. One observes an exception in BRAC Bank's SME activities. However, that is said to be possible due to management's recognition of two segmented markets where the bank charges differential interest rates.[22]

3. Refinance once formed the most lucrative incentive for the lending institutions, but the *modus operandi* is reported to have been difficult to pass on the benefit to the borrower on time. Refinancing allowed commercial banks and NBFIs to avail fund at low interest rates (5%), and had been an attractive option when they could lend at high interest rates. With declines in deposit rates, the cost of fund to commercial banks and NBFIs has declined (reportedly, below 5%), and

[22]It is widely known that the MFIs charge higher interest rates. With zero slacks in utilisation of bank fund, the annualised interest rate is calculated to be 25% or more. In contrast, the client groups of most commercial banks borrow large amounts at presumably lower annual interest rates, currently, in the range of 10 to 15%. One view in the literature suggests that these are two 'segmented' markets and financial products served in the two markets are not comparable.

the lending rates have also declined. Thus, commercial banks find little or no interest in availing the option offered under Refinancing. Though bank-level data on availing refinance fund could not be availed, the FGD revealed that such facility was (more likely) being availed by fourth-generation banks having shortfalls in liquidity.

4. Preferential (lower) loan provisioning for unclassified SME loans still remains attractive. With any amount of annual disbursement, 25% of which are reported to be under SME financing[23], and given a profit-disbursement ratio of (say) 0.05 (=5%) and a tax on profit @ 42.5%,an additional amount of almost 26% of the post-tax profit can be retained for distribution if loan provision is reduced from 1%to 0.25%. For an annual disbursement of (say) Tk. 1,25,000 crore, the size of additional profit for redistribution in a year can be as high as Tk. 234 crore.[24] The calculation does not address the additional revenue that may potentially be generated with the retained fund, including all effects of money multiplier. It is therefore no wonder that the banking community was (could be) incentivised by reduction in loan provision under SME financing.

5. The above-mentioned inducement could encourage more lending to the target enterprises, or, could lead to biased reporting of accounts, and the possibility of the latter makes it difficult to verify the former using existing (reported) data. Several consultation sessions confirmed that reporting on SME loan disbursements have often been an *ex-post* activity and it could be done more efficiently by those who had computerised data at branch levels.

6. Private commercial banks as well as the NBFIs find the definitions of mSMEs, in terms of both replacement value of 'fixed assets' and employment size, operationally difficult to adhere to. For them, the variables that define target population are stocks (e.g., fixed assets), which do not normally have one-to-one relation with turnover. A small-sample survey administered under the study reveals presence of large proportion of outliers when enterprise-level value of assets (other than land and building) and turnovers are compared (see Table A.6.2).

7. Employment figure to target enterprises is found to be equally flawed by well-meaning bankers. Several categories of employment may be cited – casual/daily, part-time to permanent (salaried); home-based workers tied to enterprises through putting-out system or some other form of labour arrangement; and there is wide range of skill-mix. With heterogeneous labour, no unique relation between turnover and employment size, or between employment size and replacement value of fixed assets is expected.[25] Several activities may be cited which are small in terms of business, but very large (and by definition, highly labour-intensive) on account of

[23] The arithmetic is meant for illustration, but uses real world figures. See Table A.7.1 on reported share of SME in total bank disbursement, assumption of 5% pre-tax profit on disbursement came out of consultation with banking community, and the annual disbursement figure is a close approximate.

[24] For every 100 taka disbursed, pre-tax profit is 5 taka and post-tax profit is 2.875 taka [5*(1-0.425)]. With 1% loan provisioning, redistributable profit is 2.875 – 1.0 = 1.875 taka. Redistributable profit increases to 2.625 taka if loan provisioning is 0.25%. The additional (2.625 – 1.875=) 0.75 taka can be expressed as 26.09$ of pre-tax profit.

[25] One could rationalise choice of employment figure to target sectors if it was a good proxy and less costly to observe. At an aggregate industry level (such as, manufacturing and services), for which the IP provides different definitions, the proxy does not appear to work (see Table A.6.3). Moreover, economic activity of a business is more readily observable.

employment (and often, turnovers). One example is the recycling of waste fabric for stitching activities involving home-based women workforce, but coordinated by a women entrepreneur facing difficulty in accessing bank credit. Shoe-making is another example where the fixed asset is very low, though employment and turnovers are high.

8. MFIs have incentives to increase loan sizes and therefore define microenterprises in terms of loan amount, and report on mE loans accordingly. The PCBs are less keen on lowering loan sizes[26]. Thus, almost unanimously, the supply side actors proposed turnover as a workable definition to target a segment of their clients[27]. It is also worth noting that almost 75% of all SME loan amount went to trading activities (see, Table A.7.4), and the corresponding share increases to 85% to 90% when microenterprises are considered.

9. The offer of opening up SME service centres is believed to have been availed to expand banks' network in locations, which would not have been possible under general regulations. While no conclusive inference may be drawn in the absence of location-specific figures on such centres, several stakeholders opined that crowded trading centres, often in Dhaka, were in the first choice set. There is possibly a need to look closely into the matter.

10. Our FGD discussion reveals that the WE segment possibly runs a high risk of recovery failure[28]. The purported benefits like refinance, collateral-free loan as such are not rightly utilised. WEs have been defined as a business unit where the entity is owned by women sole proprietor or 51% of the shareholding belong to women. The definition perhaps needs a revisit to ensure that the enterprise is indeed owned and managed by women. There is also a need to develop mechanisms to reduce default rates.

11. BB credit policy had directives to achieve 20% of total lending to SME sector of which 15% ought to be lent to WEs. Section 2.2 of SMESPD master circular also instructed the banks and NBFIs to increase the share of total loans to SMEs from 20% to 30% in next 5 years. There are also directives to ensure that at least 40% of all SME loans go to small (and micro) enterprises. The targets have however remained unfulfilled. Several stakeholders suggested that the pressure do 'work in this culture'.

12. The nationalised commercial banks (NCBs) are unable to avail refinancing facility due to having high NPL. They do however get the benefits of lower provision for SME loans. It is often argued that the NCBs, with their branches spread widely across the country, are better able to reach out to the cottage, micro and small enterprises in rural areas. One of the FGDs revealed that the branches of NCBs at upazila levels have limited capacity, most of which have to be devoted to service government social and other programmes involving money transfers. The

[26]An exception has been the BRAC Bank, which possibly accounts for almost half the number of loans because of their extensive involvement with micro enterprises.

[27] In reality, bankers look into credit worthiness of business in annual turnovers, which is comparable to monthly or annual income (flow) for individual clients.

[28] No figure could be obtained on the NPL. A BB survey (Younus 2014) found 7% of the women borrowers to be 'irregular'. It also noted banks with aggregate NPL less than 10% and compliant with capital adequacy ratio (CAR) were eligible to participate in refinancing scheme.

latter involves large number of clients who, it is alleged, often crowd out the (potential) banking population.[29]

11. Monitoring such processes as loan application turn-around time, tracking borrowers via mobile contacts, etc. consume valuable time of officials at BB and bank branches. Moreover, there is heterogeneity in the software used by individual banks, making real time monitoring difficult.[30]

IV.1.2 Demand Side

1. CIB clearance was raised at several FGDs, particularly from the borrower sides. Concerns were raised on delays and possible dillydallying by bank officials who may blame the CIB unit for delays. It was therefore suggested by few if CIB clearance could be waived for SME loans, particularly the ones within one lac taka. Presence of precedence in agriculture loan was cited, where, reportedly, CIB is waived for loans below Tk. 2.5 lac. The majority, among bank officials as well as from Association Heads/Presidents, were however against such proposal. The urge has been for quick clearance (decision), and client's easy access to such decision. It is proposed that information be posted by CIB unit on such decisions against unique loan application numbers, so that privacy is not compromised.

2. Collateral is an important issue. Some entrepreneurs in rural/upazila settings mentioned that the bank official consider only land within municipality areas. It was suggested that the urban human habitats often expanded beyond the limits officially set for municipalities, outside land be also considered as collateral.

3. The issue of collateral came up more emphatically in discussions with manufacturing units among micro and small enterprises (particularly, in Bhairab). Their demands for finance could not be met by existing loan products with fixed repayment period, which made the loans costly for their business. Thus, the demand was for CC loan, which the banks normally offer to large borrowers and against which there are collaterals. The small entrepreneurs felt that options to get CC loans would immensely help their business and they would be encouraged to bank more often than not.

4. Small manufacturers felt that there is a distinct trade-off between cost of finance (reflected in interest rates) and wage rates that entrepreneurs can/are willing to offer to workers. Thus, there is a need to make finance available to them at low interest rates (single digit, preferably at 7% per annum). This would allow them to raise wage rates to attract skilled labour.

5. Most micro-level (and less educated and less articulated) entrepreneurs recognised the need for registration in order to avail bank loans. However, apprehension of harassment for tax

[29] The claim may not be sufficient to argue that the NCB branches at upazila level would reach out to mSEs if the government opted to withdraw from those services. The InM Study (2016) notes, 'physical proximity on its own is rarely sufficient for serving micro and small customers'.

[30] Several BB officials suggested that adaptation of standardised accounting software would ensure greater transparency in banking transactions and thereby would ease monitoring.

collecting authority (as well as the additional burden of tax obligation) deterred them to take that route.

6. The terms and conditions that apply to a loan are not transparent to many due to writing in English and in small fonts. There has been one in Bangla that has been introduced, but illegible. The team came across people who perceived the terms that differed widely from the actual.

7. Group guarantee is said to have generally failed to ensure healthy repayment.

8. There are demands for common facility, such as, machineries for finishing leather products. However, individual producer is unwilling to take the risk, nor the liability of a bank loan.

9. The non-financial services, such as, marketing, technology, competition from foreign goods, etc. were identified more important than finance.[31]

IV.1.3 Regulators and Policymakers

1. Proliferation of projects and mixing up of roles as regulators and service providers within the BB has been a concern.

2. Excessive bias in current lending towards trading is a concern.

3. Increasing NPL in certain categories of loan products may adversely affect the financial health of lending agencies.

4. There are several bank-specific accounting software, which are hindrances to effective monitoring.

5. Need for greater coordination across policymaking agencies is recognised.

V. Looking into Future – Summary and Recommendations

Without being narrowly prescriptive, the first part of this concluding section outlines the context within which policy options for future ought to be mooted. In doing so, it touches on the history, experiences from implementation of past policies, and the roles of BB envisaged in the proposed SME development strategy of MOI. The second part makes specific recommendations, some of which are in the form of alternatives from which BB policy makers may choose the feasible ones.

[31] The general views of agencies such as PKSF and SMEF have already been discussed, and therefore, are not repeated here.

V.1 Summary – history, lessons and current context

The study developed a conceptual framework in Figure 2 which will presumably provide a meaningful way of discussing BB's roles in the financial market, particularly the segment that aims at facilitating inclusive growth in the real sector of the economy. While the framework may allow one to address issues on relative importance of regulatory and development roles and their inter-linkages, we confine to the segment that dealt with SME financing.

The tradition of classification is an age-old practice in statistics, and has been applied in empirical work, particularly to capture land (and asset) ownership distribution and income inequality. In the same vogue, past practices in Survey of Manufacturing Industries (SMI) in Bangladesh, dating back to 1972-73, had looked into values of output and various assets, including inventory. One important purpose of such exercises was to estimate value addition, to be used in national income accounting, as well as for monitoring. Classification turned out to be an art when its use for transferring resources to a target population came of importance; and (subsidised) credit increasingly became an attractive resource that got transferred to 'targeted' countries and to 'targeted' segments within a population, enterprises or geographic space.

Transfer of (credit) resources did not have to be targeted to 'SMEs', nor did such transfers have to be channelled through BB. The buzzword that we name SME, however, entered the arena of international aid transfers and development banking in Bangladesh during 2003-04. More specifically, with the ADB loan project on SME development, that coincided with BB's publication of 'Prudential Regulations for Small Enterprise Financing' in 2004, and 'Policy Strategies for Development of SME' by MOI (2005). BB (2004) had addressed only SEs, with thresholds defined separately for service, trading and manufacturing. In contrast, MOI (2005) had defined the thresholds for manufacturing and non-manufacturing under Small and Medium, with more liberal upper limits on Fixed Capital Investment (Table A.5.5). Subsequently, BB picked up the term 'Medium' in 2007 (Table A.5.2), and had operational definitions in place by 2008; paving the way for alignment of definitions since IP 2010.

One conclusion from the above narrative is, there were times when BB had proposed definitions of SE and ME to target finance, remaining within the broader spirit of the strategy adopted by a line Ministry (MOI). There is a second element in the SME financing as practiced in Bangladesh and elsewhere. In several other programmes of transfer of public resources, intermediary agencies providing the delivery service are paid fees, and no incentive changes are introduced that may adversely affect their regular activities. This is not the case with BB's SME financing. Other than instructions to conduct business in certain manner, or to provide non-financial services (such as, training to women entrepreneurs), BB's SME financing opted for financial incentives to participating banks and NBFIs in the forms of Refinancing and Loan provisions. In addition, share of loan disbursement to SMEs was included in the measurement of banks' CAMELS rating, with reportedly, negligible impact on performance measure. It has been mentioned that the most effective tool had been (and continues to be) a lower loan provisioning tagged to disbursements to SMEs. Unfortunately, such incentives led to malpractices in reporting, with potentials to adversely affect the governance of the sector.

Lessons from targeting in several fields of development (e.g., food distribution and credit) raise several other issues that may have relevance for targeted financing, either directly undertaken, or facilitated by BB. First, targeting may avail more than one option, particularly when there are strong correlates of the target variable (say, size of enterprise). Thus, the same objective may be achieved by geographic targeting (say, rural as opposed to urban, or, specific clusters), targeting specific sectors or economic activities (say, foundry or shoe manufacturing), demographic targeting (e.g., women or specific age group), etc. While some of these items have been addressed partially, there has generally been a lack of appreciation for alternatives.

The targeting literature also mention of developing products and delivery mechanism which have built-in bias against client group one would like to exclude (large enterprises), and favour inclusion of those who one would like to include (say, mSEs). This appropriately applies to a broad range of products currently being foreseen under the umbrella of innovative financing, such as, value chain and work order & factoring[32]. In addition, there are certain systemic changes involving wider application of information & communication technology (ICT), which are expected to increase banks' outreach by reducing risk and/or enhance access of micro and small enterprises to bank credit by increasing transparency (and trust) and reducing transaction cost. Some such examples include, National Payment Switch (NPS), Credit Information Bureau (CIB) and e-commerce on credit disbursement side. Similarly, one may cite mobile financial services for payment and recovery, and publicly available e-platform with information on status of loan applications. In areas of both appropriate product designs and systemic changes, access to finance by mSMEs may be indirectly facilitated through supports to complementary activities.

To bring the discussion to the current context, two developments are highlighted. The first involves the institutional space, and the second pertains to Strategy for SME Development that awaiting government approval (discussed later).

Figure 1 in this report identified the two sets of financial organisations starting off from two opposite ends of the spectrum (of clients). There is no hard evidence as to whether the two arrows overlap. While MFIs continue with their mainstream IGA loans, many have separate windows for 'microenterprise loans', and hardly 10% of the borrowers from the latter group is said to 'graduate' to access credit from commercial/formal banks[33]. As there are signs of saturation in the mainstream microcredit market supporting IGAs (and with increasing financial self-reliance of MFIs), MFIs are redefining their developmental role and finding it within the boundaries of their legitimate credit operations to promote credit constrained small enterprises that are scaled up beyond IGAs. Yet their clients do not overlap with the clients of commercial banks. There has generally been a failure to appreciate that the two markets are segmented[34]. More importantly, the two segments cannot be distinguished by simplistically associating cottage

[32] Value-chain financing and work-order financing are practiced in several parts of the world (ACCA, 2014). By ensuring capital generation for suppliers at the lower end of the value chain, work-order and value-chain financing have generally proved advantageous in countries like Spain, Mexico, as well as in Bangladesh. An exemplary practice thereof can be drawn from East African countries where an enabling environment was subsequently developed for the local coffee producers through a programme dubbed The Coffee Initiative (Snyder, 2015).

[33] Credit and Development Forum (CDF), *Bangladesh Microfinace Statistics 2012.*

[34] Sustenance of different interest rates in the two markets with no signs of integration is indicative of segmentation.

and micro with MFI-served market, and associating SMEs with financial market served by banks and NBFIs[35].

This subsection is concluded with an update on the proposed action matrix in SME development strategy. The details on action matrix are included in Annex 9 and several observations are made in Annex 10 on BB's roles proposed in the strategy paper. Beyond that discussion, the three distinct roles of BB conjectured with regards to mSME may be worth repeating. First, to play supportive role in realising the objectives envisaged in the Industrial Policy and the SME development framework (once approved). Secondly, to provide policy and regulatory supports to the lending agencies to encourage them in promoting target sectors. Finally, take regulatory and other measures to ensure protection from (possible) negative effects of engaging financial organisations in development activities. On the first, several observations have been made in the Annex 10, and it would be premature to elaborate further till the SME development framework is finalised. One limitation of the Strategy paper (on SME development) is in its failure to appreciate the various roles of BB.

V.2 Recommendations – definitions, delivery mechanism and institutional arrangement

Of the four overall objectives of this study, stakeholders' perspectives have been documented. This report is concluded in this section with specific recommendations on the other three themes, along with rationale. The themes cover, suitable and unified definition, on having (or, not having) two separate policies for financing of different enterprise segments, and recommendations to further improve Bangladesh Bank's current SME Policy. The last theme is discussed at first as well as at the end. Attempt is made to sequence the recommendations in a logically sequenced manner.

1. Need for an umbrella policy for development financing:

Currently there is much arbitrariness in BB's engagements in development oriented financing activities. Such a situation, if unattended for too long, may adversely affect institutional culture and give rise to conflicts between BB's dual roles pictured in Figure 2 in this report.

Thus, it is recommended that a single unified development financing policy framework be developed that addresses working through/with, (i) private (and foreign) commercial banks & NBFIs, (ii) nationalised commercial and development banks, (iii) MFIs through MRA, (iv) other ministries and departments within the government who need supports on the financial front, and (v) other development agencies, including external development partners (EDPs), who are keen on promoting a target sector and need collaboration with domestic financial organisations.

2. SME financing policy to be subsumed under the umbrella policy as a targeted programme:

Ideally, SME or mSME financing policy can be subsumed under such an umbrella policy framework. In this regard, BB may like to keep its options of engagements open by not adopting

[35] In the former case (MFI), allegation of 'mission drift' may be misplaced, which unduly constrain organisational transformation and legal framework to realise requisite transformation.

a single set of implementation rules[36]. An extreme position would be to define the policy, ruling out BB's engagement as 'service provider'. However, given the extent of current interests among different stakeholders, such a role may be unavoidable in foreseeable future. Thus, BB may choose to include specific measures in the unified policy aimed at eliminating or reducing negative fallouts arising from conflicts between BB's role as a regulator and its engagement as a 'service provider' under the guise of development finance.

On Definition:

3. Almost by definition, mSME financing policy applies to a subset of targeted programmes which aim to promote mSMEs. Like every other targeted programmes, such a policy would have to address operational definition of the target groups to whom resource transfers are desired. However, the purpose, and therefore, the targets may vary between programmes. In its role as a regulatory body in the financial market[37], BB does not need a definition of mSME, other than for distributional concerns. The latter (i.e., distribution) does not require cut-offs for operational distinctions between segments of enterprises, and instead, can be addressed with distribution of enterprises over a single variable. An example would be loan size, or business turnover, etc. The compulsion to define arises when resource transfers are targeted, and in the context of mSME financing, BB has to deal with at least three variants of transfers. The report took note of, (i) IP and SME strategy of MOI, (ii) projects under EDP lending programmes, and (iii) BB's own programme in line with the government's overall strategy for inclusive growth. Since purposes and therefore targets may vary, one may allow for separate sets of definitions to apply, and it is recommended that the mSME financing policy remains sufficiently flexible to accommodate such variations.

4. In the very last case, the basic guiding principle recommended is that of expanding financial inclusion by dealing with the problems faced at the margin.[38]There are two suggestions in this regard.

4.A. The need to reach out to currently non-bankable (but willing) parts is recognised. The policy may be designed to identify more explicitly the 'non-bankable' component in terms of some observables, such as, territory (rural, or specific districts or upazilas), narrowly defined economic activities (such as, agro-based light engineering, or, producing units supplying to a firm in the formal sector). With the advancement of IT application, mobile banking and fruitful implementation of agent banking, problems of accessing finance is expected to be reduced, making size-based concept of 'missing middle' less attractive.

[36] Ideally, a unified development financing policy of BB would distinguish between targeted and non-targeted (inclusive) programmes, and mSME financing would fall under the targeted financing. All inclusive financing programme should not be mixed up with Financial Inclusion. The latter may be realized by targeted as well as non-target (all inclusive) programmes.
[37] As shown in the Figure 2, it regulates part of the market where banks and NBFIs operate.
[38] Past practices of moving from formal to informal sectors is one example, and moving from import-export business to large manufacturing and subsequently to small enterprises, is another example. From the banking sector perspective, moving from large-scale loans to smaller sized loans is similarly a desired route to take. In all these case, the "margin", perceived synonymous with 'frontier', is a moving target, and a standardised static definition may hinder the progress in financial inclusion.

4.B. For the purpose of monitoring progress, distribution of enterprise loans in terms of such dimensions as value of fixed assets, value of gross output or turnover, or employment size. Choice of cut-offs for size classes in such cases are to be generated from the distribution in existing data. It is recommended that BB undertakes in-house study to find suitable variables and classification of business clients in terms of those variables. Since targets may vary across stakeholders on the supply side, no unique package for targeting is called for.

5. In cases where BB accepts to implement a programme of MOI or of an EDP, the target segments (mSMEs) are expected to be defined by the former. In light of past experiences, it is recommended that such approaches to transfers be not encouraged, since it encourages accounting malpractices defeating the purposes of the transfer programme. Instead, emphasis may be given on product designs (see below) which have in-built bias in favour of marginal segments of the clients within the business group.

6. Given that the IP 2016 has been okayed by the Cabinet, and given the changes in the departmental structure within BB, it is probable that BB will have to fulfil obligations to MOI and EDPs. It is recommended that detail loan and client level data be used to translate their cut-offs (e.g., lower and upper limits in terms of asset value or employment size) to reasonable cut-offs on the loan size and turnover scales for each sub-sector of economic activities. Using those cut-offs will have no or insignificant negative fallouts, and yet, allow the programme to achieve.

On the Modality and institutional arrangements:

7. The two markets served by commercial banks and the MFIs are segmented, and the stakeholders as well as the products (and interest rates) are not comparable. It is also suggested that the two cannot be distinguished in terms of segments within CmSME defined in the IP 2016. Thus, rather than making MFIs responsible for Cm and commercial banks and NBFIs for SM, enterprise development may be better promoted by assigning the two segments to two different groups of supply-side stakeholders. In each segment, the problems of expanding the financial net at the margin have to be dealt with separately.

8. It is recommended that separate CmSE policy frameworks for lending programmes be defined for respective segments. We recommend two separate guidelines. One, in the domain of MRA, is for the MFIs to guide them in reaching out to cottage and micro-enterprises, and subsequently to small enterprises, without succumbing to alleged mission drift. The other is for the formal banks and NBFIs, encouraging them to extend their lending to small and micro-enterprises. While the former is tied to MRA's regulatory and supervisory roles in MF sector, the general principles may be laid out in the overall unified policy guidance of BB. The latter clearly remains within the jurisdiction of traditional banking organisations. Sufficient flexibility may remain for potential overlaps as well as collaboration between the two segments. Having a CIB for MFI lending and real time information exchanges via the two CIBs would facilitate such collaboration[39].

[39] The importance of credit history as a component of banking knowledge needs appreciation by all, and MFIs contribute towards building that history and act as breeder of future clients for the banks.

9. Those (willing to borrow) not included in the financial/lending net are either due to high transaction cost (of reaching them), or, the risk in lending them is exorbitantly high. It is conjectured that the former will decline with the advancement of technology, and the policies in BB's financial inclusion department will have bearings on it. Thus, BB's SME financing policy ought to include measures to reduce risk. Introducing Credit Guarantee Scheme under appropriate authority, and avoiding conflict between regulator and service provider, is recommended. Other innovative financing by banks, as recommended in the SME development strategy, is in the same direction of reducing risk of individual stakeholder through risk-sharing arrangement. BB may consider the option to develop strong in-house capacity to develop financial products.

On Instruments of Transfers:

10. Incentives such as through refinancing or loan provisioning can only work if there is effective monitoring and the monitor-cum-regulator remains immune from all allurements. Increased use of technology, already under way, can ensure it. However, BB needs to issue guidelines on software within which individual banks and FIs need to store information, and appropriate interface ought to be developed in order to access those information for reporting, oversight and inspection[40]. Since the distortion in the market has already reached a point, BB may like to asses and take appropriate measure. In the absence of such facility, the likelihood of misusing incentives cannot be ruled out. It is recommended that the issues raised in this report regarding increasing ineffectiveness of refinancing and misuse of loan provisioning incentives be critically examined, and appropriate decisions be made on the choice of such instruments.

11. BB's mSME financing policy needs to formally recognise the importance of product design and its relative merits in targeting segments of business enterprises. Several proposals raised in the SME development strategy of MOI on innovative financing (value chain financing, work-order financing & factoring), etc. should be actively pursued with a view to reach out to 'marginal' enterprise segments in each of the two markets.

Other recommendations at the systemic level to promote mSME financing:

12. BB Credit policy may develop a standard simplified form in Bangla, especially for micro and small enterprises, as well as for small borrowers, and make its use mandatory for all lending agencies.

13. Open access e-platform: to enable loan applicants to know the status of their applications, as well as other information (such as, charges and eligibility criteria for accessing special loan programmes.

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[40] Standardising core banking system is unlikely to gain acceptance from the banking community. Banks select such systems based on their individual requirements and standard procurement procedures. We argue for a balance between extreme standardisation and anarchy in accounting, and hoping that individual client/customer information is not made available without knowledge of the latter party.

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Annex 1: Terms of Reference/ Scope of Work

Review the SME Credit-related Policies of Bangladesh Bank: Identify areas of further improvement by focusing on MSE finance

A1.1 Project Background

Business Finance for the Poor in Bangladesh (BFP-B) is a five year programme funded by UK aid from the UK government. The Bangladesh Bank is the implementing agency, and the Bank and Financial Institutions Division of the Ministry of Finance, Government of Bangladesh, the executing agency. Nathan Associates (London) Ltd, in consortium with its partner, Oxford Policy Management, has been appointed as the management agency for the programme. The programme seeks to promote innovative finance for small business and is designed to couple social and economic welfare objectives with a deliberate, commercially-sound approach to foster increased access to finance for Bangladesh's micro- and small enterprises (MSEs), especially those that are currently unserved / underserved by the formal financial sector. BFP-B seeks to contribute to inclusive economic growth in Bangladesh. BFP-B has three components, a Challenge Fund, a Credit Guarantee Fund, and a Policy Component. The Challenge Fund will catalyse and support innovative lending products and delivery channels to foster financial inclusion; the Credit Guarantee Fund will support bank finance to hitherto unbanked, but creditworthy, MSE borrowers; and the Policy Component will work as a support function for these two components, unblocking regulatory barriers. The Policy component of the BFP-B programme is focusing on facilitating a collaborative approach to financial sector policy and regulatory reform to create an enabling regulatory environment for the MSE sector in Bangladesh and increasing financial inclusion for small business. . This scope of work is part of the policy component, which is overseen by a 'Policy Advisory Committee (PAC).

A1.2 Background and Context of the Study

The Bangladesh Bank (BB) has championed the expansion of SME finance in Bangladesh and provided guidelines for the inclusion of micro and small enterprises (MSEs). The SME policy has provided guidelines to banks and Non-Bank financial institutions (NBFIs) on area approach method, cluster development strategies, targeting the SME sector, and refinancing schemes. Observing growth potential, the banking sector has further improved its focus on the small business financing in Bangladesh. However, BB SME policy covers both MSEs as well as medium enterprises. The banking sector and other experts, academics/ think tanks have often discussed whether two separate policies are needed i.e. one for MSEs and the other for medium enterprises. According to BB's definition there is a large range between micro and medium enterprises in terms of value of fixed assets and number of workers. There is an even bigger difference in the skills sets, track records, risk profiles and financing needs for this diverse group of enterprises. While large number of small businesses need mass market products, many of the small/medium enterprises are likely to have more specialised financing needs.

BB is following the SME definition of the National Industrial Policy 2010 developed by the Ministry of Industries of the Government of Bangladesh (GOB). The Industrial Policy 2010 defined micro, small and medium enterprises (mSMEs) based on the value of the fixed assets excluding land and factory or number of workers.

The Ministry of Industry, GOB is developing a revised National Industrial Policy 2015, where SMEs have been identified as a priority sector. Along with the National Industrial Policy 2015, the government has taken an initiative to formulate a separate SME policy to provide entrepreneurs with necessary guidance and strategic support in respect of the establishment of SME industries all over the country.

During discussion with the banks and NBFIs, some banks proposed to define mSMEs based on turnover and loan ceiling and they also requested to revise the SME policy with special focus on i) detailed guidelines on establishing SME Service Centres, ii) guidelines for documentary requirements for micro, small and medium enterprises separately (currently BB has provided uniform guidelines), iii) mSME operational guidelines including recommendations on banks' SME department structure and organogram. The practical realities faced by the banks, NBFIs and other financial institutions as well as their customers have to be carefully considered while finalising the policy e.g. small businesses need a variety of financing products (term loans, working capital, overdraft, savings accounts etc) and services (e.g. paying employees and suppliers); many micro businesses may not have substantial fixed investments, may not be formally registered and are sometimes financed directly from the personal account of the promoter. In addition, a clearer definition will also help in collection and analysis of appropriate data which can help policy makers to assess policy outcomes and consider whether further policy changes are needed. During the BFP-B Policy Advisory Committee meeting, the issue of definition of mSME was discussed.

In this context, the policy component of the Business Finance for the Poor in Bangladesh (BFP-B) programme is commissioning a comprehensive study titled 'Review the SME Credit-related Policies of Bangladesh Bank: Identify areas of further improvement by focusing on MSE finance' to understand the stakeholder's view on current SME Policy of BB and areas of further improvement.

A1.3 Objective and Purpose of the Assignment

The overall objectives of this study are to

- understand the stakeholder perspectives and experience of using the mSME and SME Policy of BB,
- come forward with a suitable unified definition of mSMEs that will contribute to the current draft SME Strategy document of the Ministry of Industry.
- appraise the feasibility of developing two separate policies on MSEs and medium enterprises financing for BB.
- make recommendations for further improvement of BB SME Policy,

A1.4 Scope of Work

The study is expected to cover five broad areas:

i) Supply side perspective: The supply side perspective will explore the pros and cons of current mSME definition in consultation with banks, NBFIs, and MFIs. It will also identify the areas for further improvement of current SME Policy of BB in consultation with banks and NBFIs.
ii) Demand side perspective: The demand side analysis will capture the key opportunities and challenges faced especially by the MSEs because of current mSME definition and SME Policy of Bangladesh Bank.
iii) Other stakeholder's perspective: The consultant will gather views of the different stakeholders on current definition of mSME and SME Policy of Bangladesh Bank. The other stakeholders include different government/semiautonomous/autonomous agencies such as Ministry of Industries, SME Foundation, Palli Karma-Sahayak Foundation (PKSF), Bangladesh Small and Cottage Industries Corporation (BSCIC); private sector associations such as banking association, chamber of commerce, women chamber, national small and cottage industries association, microfinance association etc.; researcher, academics and think tanks. The list of the stakeholders to be consulted will be finalized at the commencement of the assignment.
iv) Regulatory perspective: The consultant will seek feedback from BB and MRA on their experience of implementing the current SME Policy and identify areas of further improvement. The consultant will also explore the feasibility of developing two separate policies on MSEs and medium enterprises for BB.
v) mSME definition and good practices on mSME Policy of other countries: The study is expected to draw lessons from mSME definition used in the other countries and international institutions such as The World Bank/IFC, OECD etc. Besides, good practices on mSME Policy of other countries need to be explored.

A1.5 Detailed tasks including suggested methodology

Prior to starting the study, the consultant is expected to prepare a draft research proposal and organise a consultation meeting with the head of SME departments of 5 banks and 2 NBFIs, which have large SME loan portfolios, to refine methodology. It is recommended that the consultant will also share the research methodology with SME Foundation, Palli Karma-Sahayak Foundation (PKSF), and Bangladesh Small and Cottage Industries Corporation (BSCIC). Then the consultant will prepare a detailed research proposal with a work plan and methodology to be reviewed by BFP-B Policy Working Committee to ensure clear understanding of the methodology, approach and main deliverables. The study will involve literature review, stakeholders' consultation, analysis of secondary data and field work. The study should also assess whether there have been any unintended/ unexpected results of the policies implementation so far. The field data will be collected through organising focus group discussions and discussions with selected customers, operational staff and management of FIs/NBFIs. Consultant will be responsible for revising the approach as necessary in consultation with BFP-B Policy Team.

Literature Review: Undertake literature review on National Industrial Policy of Ministry of Industries of GOB, SME Policy of Bangladesh Bank and other key Policy documents relevant to mSME. The consultant will also review mSME definition used in other countries and by international institutions such as The World Bank/IFC, OECD etc. Besides, good practices on mSME Policy of other countries need to be reviewed. However, it is expected that the consultant will review additional necessary literature relevant to the study.

Secondary data analysis: Collect secondary data from BB, MRA, PKSF, SME Foundation and other sources to analyse the key trends in SME financing.

Stakeholder consultation: The Consultant will consult with at least 10 banks (three state owned commercial bank, one Islamic bank, one foreign bank, and five private commercial banks) and 5 NBFIs which have large SME loan portfolios to understand their views on current mSME definition and SME Policy of BB. The consultant will also consult with at least 5 MFIs, which have large microenterprise loan portfolio. Besides, consultant will interview with BB, Microcredit Regulatory Authority (MRA), SME Foundation, PKSF, Bangladesh Small and Cottage Industries Corporation (BSCIC), the Chamber of Commerce (FBCCI, DCCI, Women chambers), National Association of Small and Cottage Industries of Bangladesh (NASCIB), banking and microfinance associations, some of the sector associations (e.g. associations of plastics, footwear and leather goods, light engineering, electrical goods, handicrafts, and agro processors), and other relevant stakeholders to understand their views on current mSME definition and SME Policy of BB.

Focus Group Discussions: Organise focus group discussions (FGDs) with the representatives of different women chambers, sector associations (examples above) to understand how the current mSME definition and SME Policy of BB affect their access to finance. In the technical proposal, the Consultant shall propose the number of FGDs with the key stakeholders to be organised.
Dissemination seminar: Organise a dissemination seminar to share the draft findings of the study report. The participants of the workshop will be regulators, government agencies, banks, NBFIs, MFIs, Chamber of Commerce, sector associations, banking and microfinance associations, apex foundations, academics, research institutes and think tanks.

A1.6 Expected output

The consultancy will have four major outputs:
i) Detailed analysis of the findings of the discussions with supply side, demand side, and other stakeholders. Identify and analyse the areas for further improvement of current definition and SME Policy.
ii) Based on in depth review of the current SME Policy of BB, identify areas for further improvement, and explore the feasibility to develop two separate policies on MSEs and medium enterprises for BB.
iii) Draw key lessons from mSME definition and good practices on mSME Policy of other countries.
iv) Provide policy recommendations to Ministry of Industries to amend definition of mSME and provide policy recommendations to BB to revise current SME Financing Policy.

A1.7 Deliverables

Name	Type	Estimated Submission Date
Inception Report	Report	June 15, 2016
Draft Research Report (in English)	Report	August 31, 2016
Draft Policy Brief extracted from the research findings and policy recommendations (in English)	Policy Brief	September 30, 2016
Draft Research Report (in Bangla)	Report	October 15, 2016
Draft Policy Brief extracted from the research findings and policy recommendations (in Bangla)	Policy Brief	October 15, 2016
Final Research Report (in English)	Report	October 31, 2016
Final Policy Brief (in English)	Policy Brief	October 31, 2016
Final Research Report (in Bangla)	Report	October 31, 2016
Final Policy Brief (in Bangla)	Policy Brief	October 31, 2016

A1.8 Schedule of assignment

Estimated start date: 15th May, 2016
Estimated end date: 31st October, 2016
The schedule of assignment might be changed through consultation with BFP-B Project / Nathan Associates London Ltd. upon consent of DFID.

A1.9 Reporting

The consultant shall report to the BFP-B Team Leader, BFP-B Policy Adviser, and BFP-B Policy Manager for overall strategic and technical guidance. The BFP-B Policy Manager will work closely with the consultant, provide task coordination, attend stakeholder consultations, review the research report, and disseminate the draft research findings. The BFP-B Team Leader, BFP-B Working Committee, and BFP-B Policy Advisory Committee will approve the study report.

Annex 2: List of Stakeholders Consulted

Table A.2.1 List of Stakeholders ConsultedSupply Side

Banks

Name	Designation	Institution
Mishael Abu Imam	Head of Business Client	Standard Chartered Bank Ltd.
Mohammad Abu Kausar	SAVP	Eastern Bank Ltd.
MdMohsinur Rahman	VP, SME Division	United Commercial Bank Ltd.
Sadat Ahmed Khan	SVP	One Bank Ltd.
Masihul Huq Chowdhury	Former Additional Managing Director	ShahjalalIslami Bank Ltd.
Kazi Mahmud Karim	SEVP and Head of SME	Prime Bank Ltd.
RatantiTalukdar	SVP and Head of SME	Trust Bank Ltd.
Istiaque Ahmed Chowdhury	Managing Director	Trust Bank Ltd.
M. K. Rasedul Hasan	Head of SME and Agri Business Value Chain	The City Bank Ltd.
Shaheda Milky	Head of SME	Sonali Bank Ltd.
Ishtiaq Mohidduin	Deputy Managing Director	BRAC Bank Ltd.

NBFIs

Name	Designation	Institution
Md Kamruzzaman Khan	VP & Head of SME	Lanka-Bangla Finance Ltd.
Farzana Chowdhury	MD/CEO	Green Delta Insurance Ltd.

Start-up/Venture Capital

Name	Designation	Institution
Ziauddin Ahmed	MD	SEAF

Both Demand and Supply

MFIs/NGOs

Name	Designation	Institution
Shams Azad	General Manager	BRAC

Mosharrof Hossain	Director (Finance)	BURO Bangladesh
Pranesh Banik	Additional Director	BURO Bangladesh
Munawar Reza Khan	Deputy Executive Director	TMSS
Abdus Samad	Joint Director	ASA
Ratan Nag	Managing Director	Grameen Bank
Shah Rear Kabir	Principal Business Consultant	Swisscontact/Katalyst
Saqif Nayeem Khan	Senior Business Consultant	Swisscontact/Katalyst
Tamjid Ahmed	Senior Business Consultant	Swisscontact/Katalyst

Sector-specific Non-financial

Name	**Designation**	**Institution**
S M Shaheen Anwar	General Manager	SMEF
Md Hasanuzzaman	Deputy General Manager	BSCIC
Md Fazlur Rahman	CEO	Islami Bank Foundation

Wholesaling

Name	**Designation**	**Institution**
Fazlul Kader	Deputy Managing Director	PKSF

Associations/Chambers

Name	**Designation**	**Institution**
Ferdaus Ara Begum	Chief Executive Officer	DCCI/BUILD
Selima Ahmad	President	Bangladesh Women Chamber of Commerce and Industry
Mousumi Islam	President	Association of Grassroots Women Entrepreneurs, Bangladesh
Anis A Khan	Chairman	Association of Bankers, Bangladesh
Md. Abdul Awal	Executive Director	Credit & Development Forum

Demand Side

Sector-specific Enterprises and Associations

Name	**Designation**	**Institution**
Hazee Harun	President	Bangladesh Plastic Wholesalers Association

Mohiuddin Mahmud Mahin	Chairman	Bangladesh Finished Leather, Leather Goods and Footwear Exporters' Association
Md Khalilur Rahman	Owner	Kushiara Engineering Workshop
Nurul Islam Nilu	Owner	Nilu Engineering Workshop
Golam Azam Tipu	Owner	Pubali Engineering
Imdadul Haque	Owner	Probaho Engineering
Bashiruddin Bhuiyan	Owner	Rental agency, Narsingdi
Hazrat Ali	Owner	Tomal Poultry Feed
Md Rubel	Owner	Ifra Poultry Feed
Sattar	Owner	Fruit wholesaler
Ad Azmol Hossain	Owner	Loom-based jute sacks manufacturer
Md Hemayet Uddin	Owner	Mridha Tech Center

Regulatory Authorities

Name	**Designation**	**Institution**
Arijit Chowdhury	Additional Secretary	Bank and Financial Institutions Division, Ministry of Finance
Abu Farah Md. Nasser	General Manager	Banking Regulation & Policy Department, Bangladesh Bank
Manoj Kumar Biswas	General Manager	Sustainable Finance Department, Bangladesh Bank
Swapon Kumar Roy	General Manager	SME & Special Programmes Division, Bangladesh Bank
Md. Ashraful Alam	Deputy General Manager	Financial Inclusion Department, Bangladesh Bank
Aminul Islam	Director	Ministry of Women and Children Affairs
Shazzad Hossain	Director	Microfinance Regulatory Authority
Asif Iqbal	Deputy Director	Sustainable Finance Department, Bangladesh Bank

External Development Partners

Name	Designation	Institution
Bidyut Kumar Saha	Senior Financial Sector Specialist	Asian Development Bank
Sonya Hossain Firoz	Advisor	Sustainable Energy Development, GIZ
Ali Sabet	Team Leader	Bangladesh INSPIRED/EU

Table A.2.2 FGDs and other group-based consultations

Bank and Financial Institutions Division, Ministry of Finance

Name	Designation
Arijit Chowdhury	Additional Secretary
Md Firozuddin Khalifa	Deputy Secretary
Mursheda Zaman	Senior Assistant Secretary
Dhiresh	Senior Officer

SMESPD, Bangladesh Bank

Name	Designation
Swapon Kumar Roy	General Manager
Md Motahar Hossain	Deputy Director
Mr Mohsin	Deputy General Manager

BSCIC

Name	Designation
Hazrat Ali	Chairman
Md Hasanuzzaman	Deputy General Manager
Md. Shafiur Rahman	General Manager (MIS)

and two others

Banks and NBFIs - Session I

Name	Institution
Masihul Huq Chowdhury	ShahjalalIslami Bank Ltd.
Kazi Mahmud Karim	Prime Bank Ltd.
Ratanti Talukdar	Trust Bank Ltd.
M. K. Rasedul Hasan	The City Bank Ltd.

Banks and NBFIs - Session II

Name	Institution
Mishael Abu Imam	Standard Chartered Bank Ltd.

Mohammad Abu Kausar	Eastern Bank Ltd.
Md Mohsinur Rahman	United Commercial Bank Ltd.
Sadat Ahmed Khan	One Bank Ltd.
Md. Kamruzzaman Khan	VP & Head of SME, Lanka-Bangla Finance

Women Entrepreneurs' Associations

Name	**Institution**
Selima Ahmad	Bangladesh Women Chamber of Commerce and Industry
Mousumi Islam	Association of Grassroots Women Entrepreneurs, Bangladesh

Swisscontact/Katalyst

Name	**Designation**
Shah Rear Kabir	Principal Business Consultant
Saqif Nayeem Khan	Senior Business Consultant
Tamjid Ahmed	Senior Business Consultant

MFIs and NGOs

Name	**Institution**
Ratan Nag	Grameen Bank
Shams Azad	BRAC
Mosharrof Hossain	BURO Bangladesh
Pranesh Banik	BURO Bangladesh
Munawar Reza Khan	TMSS
Abdus Samad	ASA

Bogra Cluster: Agro-based Light Engineering

Name	**Institution**
Md Khalilur Rahman	Kushiara Engineering Workshop
Nurul Islam Nilu	Nilu Engineering Workshop
GolamAzamTikul	Pubali Engineering
Imdadul Haque	Probaho Engineering
Tahedul Islam	Towhid Foundry and Industry
Kamal Mia	FBCCI, and M/S Kamal Machine Tools Factory
Md Abdul Aziz	
Hasan Habibur Rahman	Manager, Far-east Islamic Finance Ltd.
MominulHoque	Shabu Medicine Centre (Surgical Products)
Meftaul Islam	Imperial Business Centre (Surgical Products)
Saleh Abdur Rahim	Manager, The Premier Bank Ltd.

Yarn twisting and Dyeing, Sirajganj

Name	**Institution**
Mehedi Bokhari	M/S Soheli Yarn Enterprise

Md Sarwar Hossain Sabuj	M/S Twisting Mills and Drying Factory
Muniruzzaman	Megna Twisting

Narsingdi Cluster

Name	**Institution**
Aman Ullah	Modina Enterprise, Cement
Hazrat Ali	Tomal Poultry Feed
Abdus Sattar	Fertiliser
Md Hemayet Uddin	Mridha Tech Center

TMSS, Bogra

Name	**Designation**
Hosne-Ara Begum	Executive Director
Foyzoon Nahar	Director (HRD and Training)

and 6 other senior members of the staff and adviser

Shoe Manufacturers Association, Bhairab

Name	**Designation**
A. LatifSarker	Chairman
Abdul Matin	General Secretary
Nuru Mia	Assistant General. Secretary
Sadek Mia	Member and Proprietor, Jihan Sandals

and 5 other members

Sonali Bank Ltd.

Name	**Designation**
Shaheda Milky	Deputy General Manager, Head of SME
Hafizzuman	Microcredit Department
Mahfuzur Rahman	Microcredit Department
Ms Farzana	

And 1-2 more

Note: Some individuals may be repeated from the previous section.

Annex 3: Glossary on Categories of BB's SME related Policy Directives

F =Factoring **=** If Firm A and Firm B are on two points on the value chain where the former supplies to the latter, a 'factor' would be a third party in-between, that intermediates the transaction. The factor buys the deliverables off Firm A, allowing it to raise funds immediately, and is then owed by Firm B for the invoices. Factoring as a means of raising finance is desirable for enterprises at the earlier end of the value chain in industries with relatively long-term receivables.

FInc = Financial Incentives = Monetary incentive offered (in this context, to individual financial institutions) in order to encourage certain behaviour or actions which may not have otherwise taken place. Financial incentives can increase an institution's pay-offs by either increasing their revenues, or decreasing their costs. It may also include incentives that are book-keeping in nature, and influence accounting profit, without necessarily changing actual costs and revenue.

(a) **R** = Refinancing = The central bank lends banks and other non-bank financial institutions at bank rate, which can, then, be lent to consumer groups (in this context, SMEs) at a rate determined by commercial banks (not exceeding 10%), however grant of such refinancing is subject to approval of central bank post-disbursement. The difference between bank rate and the lending rate is the margin. Note, generally the final lending rate is cheaper than the regular lending rate.
For example:
-*Central Bank* lends to *Bank PQR* at an interest rate of 5%.
-*Bank PQR* offers to lend *Entrepreneur ABC* at 10%
-If the market rate is 12%, the benefit to *Entrepreneur ABC* is 2%

(b) **P** = Provisioning = A percentage of amount disbursed, set aside to cover loan losses, e.g., on account of anticipated default, etc. A lowering in the percentage of required loan provisioning will lead to an increase in distributable profit, since provisions are deducted from post-tax profit once the profit is realised.

G = Guidelines, e.g., cluster approach, area approach, etc.

GR = General Restrictions/Regulations

(a) QR = Quantitative Restriction = The term, as coined by economists, refers to mandatory floor or ceilings on (relative) amount to be disbursed to a given sub-sector or -segment.
(b) MR = Mandatory Restriction (Conditions) = Other conditions that are to be fulfilled, e.g., advertisement in the media, having environment-friendly operations, etc.
(c) LC/LTC = Loan Terms and Conditions = Terms and conditions associated with borrowing, e.g., collateral requirements.
(d) D = Delivery Mechanisms = E.g., details on repayment schedule

LOT = Linked to Other Targets = Within the broader definition of SME, there may be specific intersectional (cross-cutting) groups, e.g., women entrepreneurs, third-gender group, or other socially disadvantaged group, that are targeted.

MC = Media Coverage

NFInc (NFI) = Non-financial Incentives = These are non-monetary incentives offered to encourage certain behaviour or actions that may have not otherwise taken place.

(a) **Awards** = Banks and non-bank financial institutions that perform well in certain fields deemed desirable by a central authority may be given special recognition. This acts not only as good publicity, but also boosts morale within the institution, and encourages other competing financial institutions to engage further in said field.
(b) **CAMELS rating** = CAMELS is an acronym comprising of Capital Adequacy, Assets, Management Capability, Earnings, Liquidity (i.e. asset liability management), and Sensitivity (to market risk, esp., interest rate). It is a means of evaluating a bank's performance and overall condition by regulatory bodies. Each category is rated from 1 (best) to 5 (worst). Banks may be awarded points in their CAMELS rating as an incentive, e.g., to expand their SME portfolios.

Non-Financial Services (NFS) = Other services provided as means of encouraging financial institutions to engage in certain behaviour and/or practices. An enabling environment could be created that eases transactions and interactions dealing with, say, SME refinancing. One-stop hotlines, help desks, etc. are other examples. It is to be noted that non-financial services and non-financial incentives are differentiated by the fact that the former is not particularly for an individual institution whereas the latter is. An example would be roads built to ease access in rural areas, where the benefits from the roads can be reaped by whichever institution agree to set up there. A common platform/marketplace may be created for exchanges between buyers and sellers, supplies, and other stakeholders of the value chain.

S = Supervision **=** Monitoring-related instructions, e.g., quarterly statements to be presented to the central bank

T = Targeted programmes such as, Women Enterprises (WE), etc.

Table A.3.1: Policy Categorisation of Selected Bangladesh Bank Decisions/actions

Policies/Decisions by Bangladesh Bank	Codes
Bank branches will play a dynamic role in sanctioning and disbursing SME credit	G
Encouraged Banks/FIs to develop 'clusters' in collaborative method to for development and expansion of sustainable and competitive technology, skill development, marketing channel development, baseline survey etc.	G
Identify real WE, assistance from BSCIC, SMEF, Mohilasamity, WEAB, NASCIB, Bangladesh Homeworkers Women Association	G
Interest rate to be reasonable	G
Quick settlement of borrower's complaints	G
Simplify Credit application forms	G
Application to CIB should be marked 'SME, the priority'	G
Rationalise timeline for credit processing	G
Respective bank branch will sanction SME loan limit considering annual requirement and following existing credit norms	G
Area approach method to be followed like agricultural sector, along with cluster based approach for risk analysis and intensive monitoring of SME loans	G (Cluster)
Banks/FIs may outsource credit disbursement to private organisations/NGOs	G/D
To match demand side, organise training, skill development, Fairs etc in association with BBTA, BIBM, DCCI, FBCCI, NASCIB, BWCCI, SMEF	G/MC
In 2010, licences were granted to open SME Service Centre to involve banks in SME and Agriculture	I
Loan defaulters will not be entitled to new loan	LC
Loan up to 25 lac against Personal Guarantee	LC
Collateral free loan up to Taka 25 lac may be given against Personal Guarantee, Group Security or Social Security	LC
Consider reasonable grace/moratorium period	LC
Special facility for women entrepreneurs (WE)	LOT
Banks/FIs will fix interest rate sector/sub-sector wise. WE 5%+ Bank rate	LOT/FI
Advertise facilities in media	MC
Banks will display information on SME credit in website, branch notice boards	MC/G
BB Area wise list of potential sectors for SME credit do not show correct information in most cases.	MC/G
Mobile phone number of each borrower should be preserved	MC/G
SME loan should extended to Rural areas instead of centralising at urban areas	MC/G
All supplementary queries should be made to the applicant in one instance	MC/G
Cell to be established to monitor SME credit disbursement	MC/G
Guidance for filling up the application form should be provided	MC/G
Mobile phone, email to be used to monitor activities	MC/G
SME officials to be rewarded, trained	MC/NFI
BB recognises that less attention has been given due to present market mechanism, as such, SME and Special Programmes Department has been established	NFS
Dedicated desk for SME	NFS

Policies/Decisions by Bangladesh Bank	Codes
SME Service Centre	NFS
Dedicated desk for WE	NFS/LOT
Service Centre for WE in selected branches	NFS/LOT
General provisioning for SME loans assigned at 0.25% (as opposed to 1%	P
At least 40% of the total disbursement target of SME should be in Small enterprises	QR
Loan of TK. 25,000 to WE against personal guarantee (PG)	QR
Special support for WE. 15% of total BB refinance for WE, interest rate not more than 10%, Loan application will be settled with highest priority	QR
Priority shall be given to small entrepreneurs (SE)	QR
SE Credit limit Tk.50,000 – 50,00,000 (Fifty lac)	QR
Success of SME loan disbursement yardstick to further approval of new branches	QR/I
Industry and Service sectors given priority over business with 100% of claims being refinanced, in order to support employment generation	R
Refinance scheme funded by Bangladesh Bank, IDA and ADB	R
Regional offices will visit branches, coordinate with HO, address complaints	S
SME programmes shall be monitored at Regional offices of the bank	S
3 tier monitoring systems → BB Head Office, BB branch office, Bank HO to achieve overall target of loan disbursement, growth of industry and service sector, district wise employment generation, credit to small entrepreneurs without harassment, monitoring of Bank's performance, ensure area and cluster based credit disbursement, recovery etc.	S
Banks are required to send to BB their target of SME loan sector wise, region wise and branch wise.	S
Definition of SME was given by Better Business Forum	T
Follow 'Area Approach Method' to attain targets branch-wise, region-wise and sector-wise	T
Target of SME loan disbursement has been introduced to small, medium and WE	T
Highest priority to small and medium WE	T/QR
Priority to WE	T/QR

Note: D = Delivery mechanism, G = Guidelines, GR = General Restrictions, I = Infrastructure coverage, M = Media coverage, NFS = Non-financial services, LOT = Linked with other targets, LC/LTC = Loan terms & conditions, FI = Financial incentives, R = Refinancing, P = Provisioning, QR = Quantitative restrictions, S = Supervision, T = Targeted programme, WE = Women entrepreneurship.

Annex 4: Narrative of a Banker involved with early SME Banking in Bangladesh[41]

Small and medium-sized enterprises account for a major chunk of employment generated in Bangladesh. Out of 43,000 business units, only 3,700 (8.5%) units fall under the definition of large-sized enterprise and the rest 39,600 (91.5%) fall under those of micro-, small- and medium-sized enterprises (BBS, 2011-12). While large enterprises employ 3 million out of 5 million, micro, small and medium enterprises may be presumed to constitute the rest. In this survey, BBS had defined the sizes of the enterprises in terms of employment size, that is, enterprises with 10-24 employees were considered to be Micro, 25-99 employees constituted Small, 100-249 employees made Medium, and enterprises with over 250 employees were considered Large. It may be mentioned that the number of manufacturing units in SME segment increased from 490,000 in 2003 to 869,000 in 2013 according to the BBS survey.

Among the key elements, the essence of 'SME' can be characterised by the following:

- Management and/or ownership of the business is within the control of the family
- Low levels of corporate governance, especially in terms of keeping the audited financials and necessary financial discipline

SMEs always played a significant role in the economic development of the country since its independence. The large businesses were established and owned mainly by the community comprising people of Iranian-origin who migrated from post-partition India in 1947. The large businesses in jute, textile, heavy tools, and tea gardens still bear the examples. Names like Adamjee, Bawani, Ispahani, etc. that are still major players in the aforementioned industries illustrate this. Businesses undertaken by those with Bangladeshi-origin were mainly small in nature, primarily due to lack of entrepreneurship, lack of capital, etc., but things changed post-1971, when a number of these local small business houses experienced a sudden surge and were able to expand. A large number of small businesses of that period have successfully grown into billion-dollar companies in terms of sales.

The other thrust in the industrial development came in the form of the evolution of ready- made garments (RMG) industry in the mid-80s. Starting from a very humble beginning, many of the smaller RMG units experienced a successful journey and made it to the big league. It is the success of these RMG units that Bangladesh has become a strategic sourcing country for all the major global brands in the apparels business, being only second to China. This is despite the negative image in international media due to the Rana Plaza disaster and the heavy cost incurred due to compliance issues.

The two examples above are a story of resilience and of success fully due to the hard work and vigilance of these businesspeople with little to no support from the policy level.

SMEs generally manage the finances through

- Family savings

[41] A narrative from a Consultant was meant to be included. In lieu of it, some aspects of it has been incorporated in Section V in the main body of the report.

- Informal lenders
- Efficiently managing their cash flow, i.e., by delaying meeting payables and expediting collection of receivables

Since independence, the state-owned banks and development financial institutions (including Bangladesh Shilpa Bank, Bangladesh ShilpaRinSangstha, etc.) have helped industrial development. This, however, got momentum with the establishment of first generation private banks. Of them, Islami Bank Bangladesh had played important role in the field of of SME financing, made possible due to a relatively larger countrywide presence and the international support from Islamic Development Bank.

SMEs, especially the middle-sized enterprises were the main focus of the commercial banks in the country. However, due to the following reasons, the commercial banks were not that aggressive in lower-middle and small enterprises:

- Excessive reliance on collateral-based lending rather than cash flow-based lending
- Limited number of branches restricting marketing drive
- Insignificant or no information technology and infrastructural support
- Lack of skilled workers in this segment
- Risk-return trade-off

Taking cue from these, SME business was launched by a multi-national bank in Bangladesh in 2003.

- Proper layout of target market and risk acceptance criteria documents whereby the parameters were defined to set up the direction for sales channels
- The bank was doing fairly well in terms of personal loan for businesspeople segment, but the ticket-size of these loans was quite small. Piggybacking this experience in terms of defining product programs for small businesses.
- Putting up the right support from information technology platform
- Robust credit policy and underwriting policy
- Cash flow based lending on 30% to 50% cash margin basis hence removing the issue of collateral
- Drawing up clear walls between small- and medium-sized businesses. While small businesses were catered by branches and sales channels, the requirements of medium-sized businesses were catered to by dedicated relationship managers.
- Properly incentivizing the sales channels to acquire loans
- Mandatory opening of transactions accounts to capture the transaction flows of the customers
- Proper early alert system for account monitoring. The recovery team became active when dues from customers went past the 30-days mark.

Fast-paced cellular communication that enabled on-time settlement of transactions is also noteworthy as one of the major influences that benefited SME and SME-banking alike.

Annex 5: Evolution of SME related Policies of Bangladesh Bank

Table A.5.1: Chronology of SME-related Policies issued by BRPD-BB

Circular/ Publication	Date issued	Code	Description	Reference	Remarks
PG for Consumer & SE Financing	2004	SE	Definitions, prudential guidelines, and development guidelines		Confined to only SE
BRPD 2004-07	03.11.2004	SE	Prudential Guidelines for Consumer Financing and Small Enterprise Financing		
BRPD 2005-10	20.08.2005	SE	Amendments to Prudential Guidelines for Small Enterprise Financing	BRPD 2004-07; 03.11.2004	Regulation 2, 5, and 13; and Appendix X under SE financing amended.
BRPD 2005-17	06.12.2005	SE	Amendments to Prudential Guidelines for Small Enterprise Financing	BRPD 2004-07; 03.11.2004	Appendix X under SE Financing revised
BRPD 2008-L#06	04.05.2008	SME, W	Introduction of SME Service Centres for loan disbursement and recovery in the Small and Medium Enterprise (SME) sector.		Transition from 'SE' to 'SME'.
BRPD 2009-06	05.11.2009	SME, A	Opening SME/Agriculture Branch	BRPD 2008-L#06; 04.05.2008	
BRDP 2011-L#10	20.06.2011	SME, G	Inclusion of solar energy system for establishment of new SME/Agriculture branch.	BRDP 2009-06; 05.11.2009	SME Branches are required to be environment-friendly.
BRPD 2012-14	23.09.2012	A, mE, SME	Master Circular: Loan Classification and Provisioning		
BRPD 2013-14	19.12.2013	SME	Access to finance in the SME sector		
BRPD 2014-03	20.02.14	SME	Mapping of SME Rating Scales of External Credit Institutions with Bangladesh Bank's SME Rating Grades	BRPD 2010-35; 29.12.2010 | BRPD 2014-01; 01.01.2014	
BRPD 2014-08	15.04.2014	SME	Mapping of SME Rating Scales of External Credit Institutions with Bangladesh Bank's SME Rating Grades	BRPD 2010-35; 29.12.2010 | BRPD 2014-01; 01.01.2014	

Notes: A= Agriculture, W= Women, G= Green,
Source: Bangladesh Bank circulars.

Table A.5.2: Expanding Domain of SME

Dates	Reference	Comments
Pre-2004	ACPD 01/2002	Loan guarantee funds for **marginal and small farmers**
2004	ACSPD 01/2004	Refinancing schemes announced for **small enterprises (SE)**
2007	ACSPD 01/2007	Special refinancing schemes for **women entrepreneurs** announced in SE sector
2007	ACSPD 05/2007	Surplus liquidity to be lent out to **small and medium enterprises (SME).** Although '***Medium***' was mentioned for the first time here, the distinction had not yet been drawn between medium and small.
2008	ACSPD 09/2008	**Broadband and IT** recognised as potential SME sector
2010	SMESPD 01/2010	**SMESPD** established in Bangladesh Bank (*ADB* funds through S**mall and Medium Sized Enterprise** Development Project)
2011	SMESPD 01/2011	**Cottage** and **Micro** were included in the commonly used buzzword, 'SME', taking cue from their inclusion in the same chapter (6) in National Industrial Policy (2010)
2013	SMESPD 01/2013	Funding assistance programme under **Islamic Shahriah-based financing** to **'Small Enterprises (including Women Entrepreneurs)'**introduced
2013	SMESPD L#02/2013	Inclusion of micro enterprises and **RMG** sector safe working environment program for development of Small and Medium sized enterprises (*JICA*)
2015	SMESPD 03/2015	FIs encouraged to lend to tribals, physically disabled, socially deprived entrepreneurs, and the people of 'third' gender group in the SME sector

Source: Own compilation from various BB circulars.

Table A.5.3: Changing Governance Structure in BB's Special Financing Programme

Date	Reference	Description	Remarks
2010	SMESPD with an elaborate guideline incorporating the definitions of the Ministry of Industries	ACSPD reorganised into ACD and SMESPD	ACD became a separate department following the formation of SMESPD.
18.03.2012	ACFID L#01/2012	ACD restructured to ACFID	ACD →Agriculture Credit and Financial Inclusion Department
11.03.2013	GBCSRD L#01/2013	Green Banking and CSR Department created	Related reports made previously to BRPD and ACFID are now to be handled by GRCSRD
15.05.2015	ACFID 03/2015	Agriculture Credit Department restructured	ACPD →ACSPD (2002) →ACFID (2010) →ACD (2015)
26.07.2015	SFD 01/2015	Sustainable Finance Department created	GBCSRD absolved
03.10.2015	FID 01/2015	Financial Inclusion Department created	Inclusion-related activities and monitoring of the former ACFID redirected. Previous relevant GBCSRD circulars are still effective

Source: Own compilation from various BB circulars.

Table A.5.4: Selected Programmes with significant overlaps with BB's SME financing

Reference	Description
Women Entrepreneurs	
ACSPD 01/2007	Special refinancing schemes for women entrepreneurs announced in SE sector; Interest rate for these loans capped at bank rate + 5%; Upto 15 lacs can be lent against only personal guarantee; 10% of SME loans to be lent to women entrepreneurs; Banks to establish advisory/service desk in selected branches to assist women entrepreneurs
ACSPD 05/2007	Banks to establish SME desks under Refinancing Scheme for women entrepreneurs
ACSPD 02/2008	Suggestion made to employ women in administration of SME desks
ACSPD 06/2008	15%-40% of SME loans to be lent to women entrepreneurs
ACSPD 2009/02	Quantitative restriction decreased, back to 10%
SMESPD 05/2009	Provision made for group-based loans, to accommodate smaller size loans so that the minimum requirement of 50,000 is met in aggregate
SMESPD 01/2013	Funding Assistance Program for Islamic Shahriah-based financing introduced to **SE** including women entrepreneurs.
SMESPD 01/2015	Women Entrepreneur Development Unit established in SMESPD to monitor Women Entrepreneur-dedicated Desks/Help Desks
SMESPD 02/2015	Each branch of financial institutions is to identify three women entrepreneurs (or those interested in availing SME loans) who have not yet borrowed, and at least one of them is to receive loans under SME schemes for her endeavours
SMESPD 01/2016	Loan amount to be availed against personal guarantee raised to 25 lacs for women entrepreneurs
Agriculture	
Pre-2004	Largely dealt with small and marginal farmers, and agro-based product processing in rural areas
ACSPD 01/2004	Included under the umbrella term SE
2004 onwards	No special provision or regulation made during this time specially for Agriculture in the SME sector
SMESPD 01/2013	Funding Assistance Programming for Islamic Shahriah-based financing introduced to 'Agro-based Product Processing Industries in Rural Areas' in SME sector

Source: Own compilation from Bangladesh Bank circulars.

Table A.5.5: Definitions of SMEs by different institutions/agencies over time

Agency	Cottage Enterprise	Micro Enterprise	Small Enterprise	Medium Enterprise
Industrial Policy 1991[1]			Manufacturing and service activities: Fixed total investment: Less than 30m (excluding cost of land, establishment, transport costs of assets, tax, and duty)	
Industrial Policy 1999[1]			FCI: Less than 100m E: Less than 50 workers	FCI: 100m to 300m E: 50 to 99 workers
Prudential Guidelines for Small Enterprise Financing, Bangladesh Bank (2004)			*Service* Fixed asset: 50,000 to 3m Employees: <30 *Trading* Fixed asset: 50,000 to 5m Employees: <20 *Manufacturing* Fixed asset: 50,000 to 10m Employees: <60	
Industrial Policy 2005[1]	In which members of a family is engaged in part-time or full-time service-oriented activities		*Manufacturing sector* FCI: Less than 15m *Non-manufacturing sector* E: Less than 25 workers	*Manufacturing sector* FCI: 15m to 100m *Non-manufacturing sector* E: 25 to 100 workers
European Commission (2005)[2]		E: Less than 10 workers Turnover: ≤€2m Balance Sheet total: €2m	E: Less than 50 workers Turnover: ≤€10m Balance Sheet total: €10m	E: Less than 250 workers Turnover: ≤€50m Balance Sheet total: €43m
BBS (2008)[1]			E: Less than 10 workers	E: 9 to 50 workers
World Bank (2008)[1]			E: Less than 50 employees, Total assets: Less than USD 3m, and Total sales: Less than USD 3m.	E: Less than 300 employees, Total assets: USD 15m, and Total sales: USD 15m.
BB, SESPD Circular 08, dt. 26.05.08			*Services* TFA: 0.05m to 5m E: Less than 25 workers *Trading* TFA: 0.05m to 5m	*Services* TFA: 5m to 100m E: Less than 50 workers *Trading* TFA: 5m to 100m

Agency	Cottage Enterprise	Micro Enterprise	Small Enterprise	Medium Enterprise
			E: Less than 25 workers *Manufacturing* TFA: 0.05m to 15m E: Less than 50 workers	E: Less than 50 workers *Manufacturing* TFA: 15m to 200m E: Less than 150 workers
Industrial Policy 2010[3]	TFA: Less than 0.5m E: Less than 10 workers* *Workers are primary family members.	*Manufacturing* TFA: 0.5m to 5m E: 10 to 24 workers	*Services* TFA: 0.5m to 10m E: 10 to 25 workers *Manufacturing* TFA: 5m to 100m E: 25 to 99 workers	Services TFA: 10m to 150m E: 50 to 100 workers *Manufacturing* TFA: 100m to 300m E: 100 to 250 workers
Bangladesh Bank (2010)[4]			*Services* TFA: 50,000 to 5m E: Less than 25 workers *Trading* TFA: 50,000 to 5m E: Less than 25 workers *Manufacturing* TFA: 50,000 to 15m E: Less than 50 workers	*Services* TFA: 5m to 100m E: Less than 50 workers *Trading* TFA: 5m to 100m E: Less than 50 workers *Manufacturing* TFA: 15m to 200m E: Less than 150 workers
Bangladesh Bank (2011-2016)[3]	TFA: Less than 0.5m E: Less than 10 workers* *Workers are primary family members.	*Services* TFA: Less than 0.5m E: Less than 10 workers *Trading* TFA: Less than 0.5m E: Less than 5 workers *Manufacturing* TFA: 0.5m to 5m E: 10 to 24 workers	*Services* TFA: 0.5m to 10m E: 10 to 49 workers *Trading* TFA: 0.5m to 10m E: 6 to 10 workers *Manufacturing* TFA: 5m to 100m E: 25 to 99 workers	*Services* TFA: 10m to 150m E: 50 to 100 workers *Trading* TFA: 10m to 150m E: 11 to 50 workers *Manufacturing* TFA: 100m to 300m E: 100 to 250 workers
World Bank (2014)[5]			E: 10 to 300 workers Total assets: $100,000 to $15m	

Agency	Cottage Enterprise	Micro Enterprise	Small Enterprise	Medium Enterprise
			Total sales: $100,000 to $15m However, the definitions vary depending on its purpose: for enterprise survey (E: 5-99), research (E: <99), or individual projects (according to specific country's definitions)	
PKSF (2016)[6]			Investment: 40,000 to 1.5m (Land and building excepted) In case the entrepreneur has multiple small-sized enterprises, combined investment cannot exceed 2m. The entrepreneur or his/her family members (from the same household) have to engage at least 25% of their time in the enterprise.	
National Industrial Policy 2016[3]	TFA: Less than 1m E: Less than 15 Workers are mostly family members.	*Manufacturing* TFA: 1m to 7.5m E: 16to 30 workers *Service* TFA: Less than 1m E: 15 workers	*Manufacturing* TFA: 7.5m to 150m E: 31 to 120 workers *Service* TFA: 1m to 20m E: 16 to 50 workers The restriction on employment size under manufacturing, however, does not hold for RMG or other labour-intensive production.	*Manufacturing* TFA: 150m to 500m E: 121-300 *Service* TFA: 20m to 300m E: 51-120 workers The restriction on employment size under manufacturing, however, does not hold for RMG or other labour-intensive production.

Notes: FCI = Fixed capital investment; TFA = Total fixed asset (land and building excepted); E = Employment size
All monetary values are denoted in taka unless stated otherwise.
Sources: [1] Islam et al. (2008); [2] European Commission; [3] National Industrial Policy, Ministry of Industries (2010 draft; 2016); [4] Bangladesh Bank (2010-2016); [5] Independent Evaluation Group (World Bank, IFC, MICA) (2014); [6] PKSF (2016).

Annex 6: Selected Statistical Observations

Table A.6.1. Size and Relative Share of different segments within CmSMEs

Primary Source	Secondary Source	Unit	Cottage	Micro	Small	Medium	Total
Number of enterprises							
Survey of Manufacturing Industries (BBS, 2012) [1]		Number		17384	15666	6103	39153
		%		44.40	40.01	15.59	100.00
Economic Census (BBS, 2013)		Number	6842884	104007	859318	7105	7813314
		%	87.58	1.33	11.00	0.09	100.00
Economic Census (BBS, 2013)	Institute of Micro-finance (2016) [Draft][2]	Number		6946900	859300	7100	7813300
		%		88.91	11.00	0.09	100.00
Size of workforce employed							
Survey of Manufacturing Industries 2012 (BBS)[1]		Number		27705	82375	109934	220014
		%		12.59	37.44	49.97	100.00
Economic Census (BBS, 2013)		Number	13168327	558870	6600685	706112	21033994

Notes: 1. Only manufacturing units, 2. Micro includes cottage
Source: As mentioned in the first two columns.

Table A.6.2 Share of different Activity-Size Enterprise Groups, BBS Economic Census 2013

Activities	C & m	Small	Medium	Large	All (row total)
Manufacturing	10.63	0.40	0.04	0.04	11.10
Other industrial activities	0.33	0.10	0.00	0.00	0.44
Trading and related activities	39.11	6.79	0.01	0.00	45.91
Transportation and storage	16.19	0.48	0.00	0.00	16.68
Other services	22.59	3.22	0.04	0.02	25.87
All (column total)	88.85	10.99	0.09	0.07	100.00

Note: InM (2016) includes electricity, gas, steam and air conditioning under 'Other industrial activities' as well; while 'other services' include, among other things, administrative and support service activities, public administrative and support service activities, public administration and defence, compulsory social security, financial and insurance activities. Our compilation in the previous Table (A.6.1) is lot narrower because of the focus.
Source: Reconstruction from InM's compilation of BBS Economic Census 2013, See, Table 1-2 in InM (2016).

Table A.6.3: Compatibility of defining targets in multi-dimensional space, 2016 Survey

Number of Workers	Monthly Turnover, '000 Taka	Value of fixed asset excluding land & building (lac taka)				
		<= 5	5 - 50	50 - 100	100 - 10,000	10,000 - 150,000
1-4	220 (1.0)	69.23	23.08	7.69		
5-9	696 (1.1)	20.00	80.00			
10-24	21875 (1.7)	25.00		50.00	25.00	
25-49	n.av.		100.00			
50-99	n.av.		50.00			50.00
100-250	n.av.			100.00		
250+	n.av.			50.00	50.00	

Note: Figures in parentheses are coefficients of variation (CV); n.av. = not available.
Figures under various fixed asset classes are row percentages. Extreme deviations from expected norms (diagonal) are considered outliers, and are shaded.

Table A.6.4: Size-Sector Relations in Enterprise-level Employment

All values in percentages.

Sector/Items	Manufacturing	Wholesale & Retail Trade, Repair of motor vehicles	Transport & Storage	Services*
Cottage				
Women	28.31	3.51	5.46	8.63
Rural	76.32	67.96	84.94	61.89
Share in sector's employment	28.85	65.82	92.00	81.09
Micro				
Women	22.16	x	x	x
Rural	61.24	x	x	x
Share in sector's employment	7.78	x	x	x
Small				
Women	24.31	14.11	10.53	14.55
Rural	66.53	33.13	34.80	19.83
Share in sector's employment	16.23	33.84	7.25	17.95
Medium				
Women	24.31	14.11	10.53	14.55
Rural	66.53	33.13	34.80	19.83
Share in sector's employment	6.55	0.16	0.37	0.38

Source: Own compilation using Economic Census data (BBS, 2013)

Notes:
-Definitions for CmSMEs used in Economic Census 2013 are consistent with that of the National Industrial Policy 2010
-Unfortunately, the BSCIC categorization used in 2013 Economic Census amalgamates repair (of motor vehicle) services with wholesale and retail trade.
-The reported numbers (e.g. for women in small-sized manufacturing enterprises) represent not women's labour force participation in that sector, but the percentage of workers engaged in that size-specific sector that are women. Therefore, if the 1,165,564 workers are engaged in small-sized manufacturing enterprises, 23% of them are women (and the rest are men). Similarly, of those 1,165,564 workers, 67% are located in rural areas (and the rest are in urban).
- Service includes: Accommodation and Food Service Activities (Hotel and Restaurants); Information and Communication; Real Estate Activities; and Other Service Activities.

Annex 7: Selected Statistics on SME Financing and Choice of Vehicles

Table A.7.1 Percentage of total loan disbursement to SMEs, by Financial Institutions

Financial Institutions	% of total loans to SME				
	2010	2011	2012	2013	2014
Total of Financial Sector	21.07	20.76	22.35	23.85	24.55
Banks	21.48	21.23	22.93	24.71	25.45
State-owned Banks	31.79	28.55	18.16	18.38	19.98
Specialised Banks	20.64	20.74	26.36	29.70	29.11
Private Commercial Banks	19.12	19.82	25.29	27.06	27.57
Foreign Banks	10.21	9.85	8.92	9.50	7.76
Non-bank Financial Institutions	13.91	12.35	12.43	11.36	11.90

Note: Our estimates differ from those provided in SME development strategy of MOI (2016), where SME loan as percentages of total loan amount from the banking sector are shown to be 16.61, 13.73, 16.02, 18.08 and 19.05 respectively for each calendar year between 2010 and 2014.
Source: Compiled from Scheduled Bank Statistics of Bangladesh Bank.

Table A.7.2 Percentage of total loan disbursements to SMEs, by types of Financial Institutions

Financial Institutions	Cottage	Micro	Cottage	Small	Medium		% share
State-owned banks	0.06	2.19	0.06	45.5	52.25		17.56
Specialised banks	5.63	26.93	5.63	55.9	11.53		0.77
Foreign banks	0.11	30.74	0.11	16.17	52.98		1.38
Islamic banks	10.53	8.66	10.53	28.11	52.7		34.33
Private commercial banks	0.1	6.12	0.1	50.67	43.1		42.21
All banks	3.86	6.83	3.86	41.23	48.08		96.26
All NBFIs	0.11	9.66	0.11	45.83	44.4		3.74
Total of financial sector	3.72	6.94	3.72	41.4	47.94		100.00

Table A.7.3 Refinancing Women Entrepreneurship, BB Extension-2014, as of 30 April 2016 - Private Commercial Banks

Name of Banks	Average loan size (lac Taka)			% share of industry	% share in all banks
	Industry	Trade	Service		
AB Bank Ltd	10.0	17.3	30.0	5.99	5.86
Bangladesh Development Bank Ltd.	9.8	8.3	11.0	26.43	3.90
Dutch Bangla Bank Ltd.	0.0	6.5	0.0	0.00	0.30
Dhaka Bank Ltd	29.7	22.0	11.6	20.67	10.07
Eastern Bank Ltd	15.0	11.7	4.5	12.70	30.31
First Security Islami Bank Ltd.	13.5	4.1	20.0	24.15	1.31
IFIC Bank Ltd	5.0	0.0	0.0	100.00	0.06
Jamuna Bank Ltd.	0.0	19.8	0.0	0.00	2.08
Mercantile Bank Ltd.	20.0	10.9	9.2	11.54	22.30
Midland Bank Ltd.	5.0	0.0	0.0	100.00	0.06
Modhumoti Bank Ltd.	0.0	4.0	0.0	0.00	0.05
Mutual Trust Bank Ltd.	6.0	5.8	5.0	30.54	2.51
National Bank Ltd.	2.3	6.3	8.0	56.16	3.79
NCC Bank Ltd.	0.0	10.9	14.0	0.00	3.00
NRB Commercial Bank Ltd.	0.0	27.5	0.0	0.00	0.64
NRB Global Bank Ltd.	0.0	0.0	6.0	0.00	0.07
One Bank Ltd.	0.0	30.0	0.0	0.00	0.70
The Premier Bank Ltd.	12.5	13.0	22.5	10.20	2.87
Prime Bank Ltd.	0.0	12.0	25.0	0.00	2.12
SBAC Bank Ltd.	10.0	13.3	0.0	33.33	0.70
Southeast Bank Ltd.	0.0	24.0	0.0	0.00	0.56
Standard Bank Ltd.	0.0	15.6	5.0	0.00	1.33
Trust Bank Ltd.	27.0	4.2	9.4	66.26	3.81
Uttara Bank Ltd.	0.0	5.0	0.0	0.00	1.59
All Banks	8.9	11.4	12.5	16.27	100.00

Table A.7.4 Refinancing Women Entrepreneurship, BB Extension-2014, as of 30 April 2016

- **Non-Bank Financial Institutions (NBFIs)**

Name of NBFI	Average loan size (lac Taka)			% share of industry	% share of service	% share in all NBFIs
	Industry	Trade	Service			
Bay Leasing & Investment Ltd.			3.00		100.00	0.05
First Finance Ltd.	5.83	8.25	4.00	12.41	5.67	4.52
IDLC Finance Ltd.	23.18	27.52	37.40	8.50	6.23	48.11
Islamic Finance & Investment ltd.		5.50	5.00		31.25	0.26
Lanka Bangla Finance Ltd.	28.00	27.00	11.00	27.72	5.45	3.24
National Housing Finance	10.00	24.21	40.00	5.01	10.03	6.40
Peoples Leasing			30.00		100.00	0.48
Phoenix Finance Ltd.		5.00				0.08
Premier Leasing & Finance Ltd.		10.11				2.11
Prime Finance & Inv. Ltd.	50.00	50.00		14.29		5.61
Reliance Finance	50.00	50.00	10.00	31.25	6.25	2.56
United Finance Ltd.	5.00	4.48	26.50	36.27	2.46	17.24
Union Capital	50.00	35.00		48.78		3.29
Uttara Finance & Investment			37.85		100.00	6.07
All NBFI	9.28	14.57	27.19	15.32	11.33	42.19
All Banks (PCBs)	8.9	11.4	12.5	16.3	7.2	57.81
All Private FIs	9.06	12.51	17.58	15.87	8.92	100.00

Note: NCBs and Islami financings are excluded.
Source: Own compilation.

Table A.7.5 Refinancing Islami Bank Loan, as of 30 April 2016

Name of FIs in Islamic Finance	Average loan size (lac Taka)				% share in all	% of loan amount collected
	Industry	Trade	Service	Female borrower		
ShahjalalIslami Bank Ltd.	401.24	22.98		13.55	72.54	64.89
Al- ArafahIslami Bank Ltd.	8.37		4.61	0.00	0.41	
Union Bank Ltd.	7.28	2.50	2.00	2.40	0.20	52.41
Islamic Finance and Investment Ltd.	300.86	27.24	85.62	23.67	26.85	78.28
All Islami Financing	256.51	22.96	30.31	11.85	100.00	68.60

Annex 8: Practices in Other Country

Table A.8.1: Summary of Practices in other Countries

	Bangladesh	India	Sri Lanka	Singapore	Thailand	Malaysia	Indonesia
Agencies involved	Ministry of Industry (policies); Bangladesh Bank (financing and credit-related policies) through scheduled banks	Ministry of Micro, Small, and Medium Enterprises Reserve Bank of India (included service sector in priority sector-lending and retains discretion to include entities in the category)	Ministry of Industry and Commerce (policies); An Inter-Ministerial Coordination Body convened by the Ministry of Industry and Commerce with other Ministries including the Ministry of Finance, Institutions and Stakeholders (coordination, facilitation, and implementation)	The Standards, Productivity and Innovation Board of Singapore (SPRING), under Ministry of Trade and Industry; Participating financial institutions provide loans but SPRING shares risk in case of default	Office of SME Promotion(OSMEP), under the Ministry of Industry; SME Development Bank of Thailand along with several scheduled banks (financing); SME Bank and Small Business Credit Guarantee Corporation (provides credit guarantee)	National SME Development Council (policies); SME Corporation Malaysia (central coordinating agency), under the Ministry of International Trade and Industry; Several participating banks including SME Bank (financing); Credit Guarantee Corporation (provides credit Guarantee)	Ministry of Cooperatives and SMEs (policies and implementations thereof); Participating banks on a contractual basis acts as a bridge for funds (including venture capital) between the government and SMEs.
Agency that defines 'SME'	Ministry of Industries	Ministry of Law and Justice	Ministry of Industry and Commerce	Ministry of Trade and Industry	Ministry of Industry	National SME Development Council	Ministry of Cooperatives and SMEs

	Bangladesh	India	Sri Lanka	Singapore	Thailand	Malaysia	Indonesia
Sizes defined	Cottage, Micro, Small, and Medium	Micro, Small, and Medium	Micro, Small, and Medium	Small and Medium (aggregated)	Small and Medium	Micro, Small, and Medium	Small and Medium
Defined differently for enterprises across industries	Service; Business; and Manufacturing	Manufacturing and Services	Not differentiated	Not differentiated	Manufacturing; Wholesale; Retailing; and Service	Manufacturing; and Services and Others	Not differentiated
Defined according to	Number of employees, and fixed asset (Replacement value of, land and building excepted)	For manufacturing: Investment in plant and machinery For service: Investment in equipment	Number of employees; and annual turnover	Number of employees; annual sales turnover; and percentage of local shareholding	Number of employees; and fixed asset (land excepted)	Number of full-time employees; and sales turnover	Fixed asset (land and building excepted) and annual sales volume

Source: Compiled from:
-National Industrial Policy 2010, Ministry of Industries, Government of Bangladesh
-SME Credit Policies and Programmes, Bangladesh Bank
-Ministry of Micro, Small & Medium Enterprises, Government of India (website) - http://msme.gov.in/mob/home.aspx
-The Micro, Small and Medium Development Act 2006 (2006:27), Ministry of Law and Justice (Legislative Department), Government of India
-National Policy Framework for SME Development, Ministry of Industry and Commerce, Government of Sri Lanka
-The Standards, Productivity and Innovation Board (SPRING) of Singapore (website), Ministry of Trade and Industry, Singapore Government - http://www.spring.gov.sg/
-Office of SME Promotion, Thailand (website) - http://www.sme.go.th/eng/
-SME Corporation, Malaysia (website) -http://www.smecorp.gov.my/
-Bali International Consulting Group (website) - http://www.bicg.org/bicg.php?sectionID=16 [secondary source]

Table A.8.2: Other Country Experiences: Definitions

Countries	Cottage	Micro	Small	Medium
Bangladesh[1]	-Asset: <1m -Employees: <15 Workers are mostly family members.	(Industry) -Asset: BDT1m-7.5m -Employees: 15-30 Service: -Asset: <BDT 0.1m -Employees: 15 workers	(Manufacturing) -Asset: BDT 7.5m-150m -Employees: 31-120 (Service) -Asset: BDT1m-20m -Employees: 16-50	Manufacturing -Asset: BDT 150m-500m -Employees: 121-300 (Service) -Asset: BDT 20m-150m -Employees: 51-120
India[2]		(Manufacturing) -Investment: ≤ INR 25 lac (Service) -Investment: ≤ INR 10 lac	(Manufacturing) -Investment: INR 25 lac-5crore (Service) -Investment: INR 10 lac-2crore	(Manufacturing) -Investment: INR 5crore-10crore (Service) -Investment: INR 2crore-5crore
Sri Lanka		(Manufacturing) -Annual turnover: ≤ LKR 15m -Employees: <10 (Service) -Annual turnover: < LKR 15m -Employees: <10	(Manufacturing) -Annual turnover: ≤ LKR 16m-250m -Employees: 11-50 (Service) -Annual turnover: < LKR 16m-250m -Employees: 11-50	(Manufacturing) -Annual turnover: ≤ LKR 251m-750m -Employees: 51-300 (Service) -Annual turnover: < LKR 251-750 -Employees: 51-200
Singapore			Annual sales turnover: ≤ SGD 100m, OR Employees: ≤200	
Thailand[2]			(Manufacturing, services, wholesale, and retail) -Asset: ≤THB 50m -Employees: ≤50	(Manufacturing) -Asset: >THB50m-200m -Employees: 51-200 (Services) -Asset: >THB50m-200m -Employees: 51-200 (Wholesale) -Asset: >THB50m-100m

Countries	Cottage	Micro	Small	Medium
				-Employees: 26-50 (Retail) -Asset: >THB 30m-60m Employees: 16-30
Malaysia		(Manufacturing) Sales turnover: <RM 300,000 Employees: <5 (Service and other sectors) Sales turnover: < RM 300,000, OR Employees: <5	(Manufacturing) -Sales turnover RM 300,000 to <15m, OR -Employees: 5 to <75 (Service and other sectors) -Sales turnover: RM 300,000 to <3m -Employees: 5 to <30	(Manufacturing) -Sales turnover RM 15m to ≤50m, OR -Employees: 75 to ≤200 (Service and other sectors) -Sales turnover: RM 3m to ≤20m -Employees: 30 to ≤75
Indonesia[2]			-Asset: < IDR 20 million -Annual sales volume: < IDR 1 billion	-Asset: IDR 10-20 million -Annual sales volume: > IDR.1 billion

Notes: 1**.** For Small and Medium, the restriction on employment size under manufacturing, however, does not hold for RMG or other labour-intensive production. Assets exclude land and building.
2. For India, investment in plant and machinery is considered, which may mean flows, comparable with loan amount associated with each investment. In case of Thailand, fixed asset excludes land, while both land and building are excluded in Indonesia.
3. The currencies are BDT = Bangladesh Taka, INR = Indian Rupees, LKR = Sri Lankan Rupee, SGD = Singapore Dollar, THB = Thai Baht, RM = Malaysian Ringgit, and IDR = Indonesian Rupiah. As of 2 October, 2016, 1 US Dollar = BDT 77.95 = INR 66.56 = LKR 145.80 = SGD 1.36 = THB 34.58 = RM 3.12 = IDR 13016.50.
Source: Own compilation with resources from:
-National Industrial Policy 2016, Ministry of Industries, Government of Bangladesh
-SME Credit Policies and Programmes, Bangladesh Bank
-Ministry of Micro, Small & Medium Enterprises, Government of India (website) - http://msme.gov.in/mob/home.aspx
- Small and Medium Business Development Chamber of India (website) -http://www.smechamberofindia.com/about_msmes.aspx
-The Micro, Small and Medium Development Act 2006 (2006:27), Ministry of Law and Justice (Legislative Department), Government of India
-National Policy Framework for SME Development, Ministry of Industry and Commerce, Government of Sri Lanka
-The Standards, Productivity and Innovation Board (SPRING) of Singapore (website), Ministry of Trade and Industry, Singapore Government - http://www.spring.gov.sg/
-Office of SME Promotion, Thailand (website) - http://www.sme.go.th/eng/
-SME Development Bank, Thailand (website) http://www.smebank.co.th/en/definitions.php
-SME Corporation, Malaysia (website) -http://www.smecorp.gov.my/, Fact sheet on new SME definition: http://www.spring.gov.sg/NewsEvents/PR/Documents/Fact_Sheet_on_New_SME_Definition.pdf
-Bali International Consulting Group (website) - http://www.bicg.org/bicg.php?sectionID=16 [secondary source]

Annex 9: Bangladesh Bank's Roles perceived in SME Development Strategy

Table A.9.1: Selected Segment from Action Matrix 2016-20 in SME Development Strategy

Goal	Strategy/Objective	Action expected from Bangladesh Bank (sic)	Remarks
1.8	Coordination between SMEF and BSCIC, BB	BB will involve SMEF and BSCIC in designing and implementing credit programs for SMEs. In particular, BB will follow the guidelines for innovative financing activities prepared by SMEF	BB may arrange co-ordination between SMEF & BSCIC by engaging Ministry of Industries. The joint committee may consider assigning the responsibilities of Cottage, Micro, and Small among MFIs; and Small and Medium segments to banks and financial institutions. However, the latter may operate in all segments through their branch networks and extended banking channels.
2.1	Establish a SME Bank.	A dedicated SME bank is necessary to be established to meet the credit needs of SMEs on a sustainable basis. Bangladesh bank will assess legal and regulatory issues for establishing a dedicated bank. If it is not feasible to establish a new SME bank at this moment, the government will restructure and rename the BASIC Bank as SME Bank to act as the prime financial service provider to SMEs issues for establishing a dedicated SME bank.	Considering the risks associated with lending to cottage and small segments where no collateral support is available, MFIs have shown considerable success. However, to provide them with better regulations, credit discipline, and better governance, an SME Bank may be established to support them.
2.2	Establish ―Lead Bank in each district.	Under the Lead Bank Scheme, each district will be assigned to different banks (public and private) to act as a consortium leader to coordinate the efforts of banks in the district particularly in matters like SME credit planning. The Lead Bank is to act as a consortium leader for coordinating the efforts of all credit institutions in each of the allotted districts for expansion of branch banking facilities and for meeting the credit needs of the SMEs.	Branches/Regional offices of the proposed SME Bank may be established to promote/support/monitor MFIs in respect of Cottage, Micro, and Small Segments. Scheduled banks may be left to usual governance by the central bank.

Goal	Strategy/Objective	Action expected from Bangladesh Bank (sic)	Remarks
2.4	Establish a SME department/unit /wing in all branches of the commercial banks.	BB will direct all commercial banks to set up a dedicated SME unit/desk in all of its branches. It will also ensure that banks do it duly. BB and SMEF will work together to reduce steps in credit allocation procedures and expedite the process of credit sanction (currently it requires about 40 days).	The dedicated desk set up is already in place. The branches may be delegated lending discretion under a well-defined policy to expedite faster loan disbursement.
2.5	Improve Credit disbursement to SMEs.	BB will supervise the activities of all SME units periodically and motivate them to encourage SME financing. A time-bound credit target for each of the units will be put in place. The growth of credit disbursement to SMEs should not be less than 20% each year (currently it is less than 20%). Create a separate women desk at the SME wing/unit at each branch to serve women entrepreneurs. State owned commercial banks will give utmost importance to SME financing.	The growth in SME segment may be set at 30% of total credit growth.
2.6	Innovative Financing for SMEs		All banks must look for new lending product solutions for SMEs so that banks can add newly revenue lines. Such innovative and timely solutions may also help different types of SMEs. • Value chain financing • Work order financing • Factoring • Start-up financing • Venture capital • Access to capital market
2.6.a	Credit Guarantee Scheme (CGS)	A Credit Guarantee Scheme (CGS) for SMEs will be developed on a pilot basis in the near term by BB and SMEF. A full-fledged CGS will be made operational over the	Insurance companies, donor agencies, lending institutions, and borrowers—All may participate in the credit guarantee scheme.

Goal	Strategy/Objective	Action expected from Bangladesh Bank (sic)	Remarks
		period of the strategy.	
2.6.b	Credit Wholesaling System (CWS)	A guideline for CWS will be prepared by SMEF and will share with BB. Subsequently, a comprehensive CWS will be developed for full implementation.	It would be ideal to have specific wholesaling systems for separate segments.
2.6.c	Streamline Equity Entrepreneurship Fund (EEF)	The current system of EEF has been largely flawed and therefore its operation needs to be modified (as per the recommendations made in the evaluation of EEF in various reports). ICB's EEF operation needs to be evaluated to increase operational efficiency and reduce corruption. Venture capital firms can be assigned to be engaged in EEF operation instead of lien bank system.	Bangladesh Bank may define an eligibility criterion to act as EEF agents under which all types of lending institutions maybe engaged. All types of lending institutions as such maybe included in the approved list of agents.
2.6.d	Factoring	Some factoring finances could be introduced on a pilot basis by SMEF with support from BB. BB will initiate factoring method of financing SMEs.	No comments.
2.6.e	Venture Capital Fund Manager	<SEC domain>	Small and Medium enterprises should be allowed access to capital market. A policy guideline may be developed in that respect.
2.7	Strengthen refinancing schemes		Incentives may be considered in terms of taxation policies, government tariffs, and rewards (e.g. recognitions/trophies) at national-level. Training and skill-development programmes may also be organised.
2.7.a	Explore more funds for refinancing schemes.	BB and MOI will enhance foreign fund mobilization for its refinancing schemes by effective engagement with existing donors and explore new donors for this purpose. The process will continue on in strategy period.	No comments.

Goal	Strategy/Objective	Action expected from Bangladesh Bank (sic)	Remarks
2.7.b	Increase Refinancing Fund.	The current BB‘s revolving fund of Tk. 600 crore is not adequate. BB would strengthen its effort to double the fund to Tk. 1500 crore during the strategy period including donor‘s fund.	No comments.
5.1	Promote Cluster and Business Network for SMEs	Bank branches may be set up in adjacent to clusters (if clusters have 50 or more SMEs) on a priority basis.	Credit policies more specific to nature of cluster should be developed for better returns.
	SME Knowledge (Web)		Different initiatives, successes, policies & business tools on SME Sector needs to be incorporated in SME Websites to allow information for SMEs, for example the SME Toolkit of ICICI bank. In addition, telephone hotlines may be created, and occasional fairs may be organised at a cluster-level.

Source: MOI (2016). SME Development Strategy, draft.

Annex 10: Brief Observations on Bangladesh Bank's Roles as perceived in the SMEDS

Each of the proposed actions is listed below with quick observations/comments in the light of discussion in the preceding sections of this report.

SMEDS #1. BB will involve SMEF and BSCIC in designing and implementing credit programmes for SMEs.
ERG #1. While assisting SMEF to find right mix of finance with their efforts to promote small enterprises is highly recommendable, there is no convincing ground to recommend that a credit program should be run by SMEDF.[42] One may like to assess their current engagement in partnership with two private commercial banks and design new programs. Thus, the recommendation may be reformulated.

SMEDS #2. Establish a dedicated SME Bank
ERG #2. Surely, there are instances of SME Banks in Thailand and Malaysia (see Table A.8.1 in Annex 8), operational success of which, however, depend on the larger institutional setting. There is also a need for providing specialised services to the 'mSME' sector, which required coordination with non-financial service providers as well. The experience in Bangladesh, e.g., with the BASIC Bank, has not however been encouraging[43]. Moreover, the proposals from some of the large MFIs to establish dedicated banks are yet to be scrutinized. If the remark under ERG # 1 is deemed reasonable, one would like to assess the two issues jointly.

SMEDS #3. Each district to be assigned to a bank to act as the Lead bank,
ERG #3. The field visits outside Dhaka and consultations with banks' representatives revealed that the efforts to experiment with lead bank for cluster development have not met much success. While concerted efforts of such kind sound positive, one needs to assess in the light of available professionalism or lack of it in the banking industry. Separate study on cluster banking/financing may look into the issue of capacity development as well.

SMEDS #4. Establish a SME department/unit/wing in all branches of the commercial banks.
ERG #4. Please see in the text our observations on SME centres.

SMEDS #5. Ensure that the growth of credit disbursement to SMEs be not less than 20% each year.

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[42] While organisations such as PKSF were mandated to act as credit wholesalers, SMEF 'is established by the Government of Bangladesh under Ministry of Industries as an apex institution for SME development in the country. The major activities of SME Foundation are implementation of SME Policy Strategies adopted by the Bangladesh Government, policy advocacy and intervention for the growth of SMEs, facilitating financial supports for SMEs, providing skill development and capacity building training, facilitating adaptation with appropriate technologies and access to ICT, providing business support services, etc.' (http://www.smef.org.bd/v2/index.php/sme-foundation/about-smef)

[43] The BASIC (Bangladesh Small Industries and Commerce Bank Limited) Bank 'was established as the policy makers of the country felt the urgency for a bank in the private sector for financing small scale Industries (SSIs).' News published in local dailies may be cited, which carried titles such as 'ACC to file 54 cases over BASIC Bank Scandal' (in *The Financial Express*, 9 September 2015), or, '27 individuals, 56 organisations involved in BASIC Bank Scam' (*Dhaka Tribune*, 23 February 2016).

ERG #5. No problem, as long as the desired target can be identified with appropriate definition and the lending agencies can be monitored in cost-effective manner.

SMEDS #6. Create a separate women desk at the SME wing,
ERG #6. Something desirable, but introducing the right incentives to motivate the branches and staffs remain a problem.

SMEDS #7. Innovative Financing for SMEs: Value chain financing, Work order financing, Factoring, Start-up financing, Venture capital, Access to capital market
ERG #7. Extremely relevant for developing the sector, and requires multiple actors beyond BB. The first three are within the current domain of banking practices, and are perceived to have bias in favour of smaller segments on the demand side (mSMEs) as well as to producers' groups. Thus, promoting those at a general level is expected to benefit mSMEs.

SMEDS #8. A Credit Guarantee Scheme (CGS) for SMEs will be developed on a pilot basis in the near term by BB and SMEF.
ERG #8. One is already under piloting, and a capacity assessment (as well as uplifting capacity with legal autonomy) may be recommended to realise objectives.

SMEDS #9. Some factoring finances could be introduced on a pilot basis by SMEF with support from BB.
ERG #9. Highly recommended. While commenting on the details are beyond the scope of the present study, allegedly the SMEF has been coordinating between regular banking channels and expertise within MOI, and because of the built-in bias of factoring finance in favour of smaller segment, the designs for piloting may emphasise on such financing.

SMEDS # 10. BB and MOI will enhance foreign fund mobilisation for its refinancing schemes by effective engagement with existing donors and explore new donors for this purpose.
ERG #10. A central bank of a sovereign country should possibly be relieved of such responsibilities.

SMEDS #11. Promote Cluster and Business Network for SMEs by instructing banks to set up branches close to clusters
ERG #11. Cluster financing needs major rethinking. Field visits to Sirajganj, Bogra, Narsingdi, Bhairab and old parts of Dhaka city and consultations with different groups of stakeholders revealed a lack of unanimity in our understanding of 'cluster'. The concepts of 'SME centres/branches' and 'clusters' have often been mixed up to expand banking networks in urban areas to access densely populated client groups. In contrast, clusters of specialised manufacturing, such as, shoe-making in Bhairab and foundry in Bogra have demands for financing investments on machineries and equipments that may be availed by many small producers. Unless requisite financial instruments are developed and their legal basis is ensured, the proposed action may remain in the realm of rhetoric. It is therefore important to define a common vision on cluster financing at the level of policymakers.

Annex 11: Responses of Clients

Table A.11.1 Disadvantages of microenterprise loans from banks (% of respondents)

Reasons	Reason 1	Reason 2	Reason 3	Row sum	% of all responses
No bank in the nearest	16.79	3.69	2.95	23.43	9.07
Need many paper works	75.46	16.24	4.24	95.94	37.14
Banks do not want to provide ME loan	3.69	35.06	16.42	55.17	21.36
Loan conditions are not business friendly	2.77	27.86	23.62	54.24	21.00
Unable to provide mortgage	0.55	8.86	18.45	27.86	10.79
Others	0.55	0.18	0.92	1.66	0.64
Percentages identifying a valid reason	99.81	91.89	66.6	258.3	100.00

Note: The InM survey listed a maximum of three responses from a single respondent.
The last column normalises the total of 258.3% responses.
Source: InM 2016.

Table A. 11.2 Sources of Start-up Finance

Source of Start-Up Finance	Employment based groups			Sectors		
	<4 (lower ME)	5-9 (upper ME)	10-51 (S)	Trade	Service	Industry
Own resource	84.13	85.13	71.77	85.35	71.83	87.31
Partner's resource	0.35	0	11.5	0.36	0	0
Commercial banks	0.99	2.56	0	0.56	0	0
Loans from MFIs	3.59	3.14	1.55	2.25	9.53	3.65
Loan from cooperatives	0	0	0	0	0	0
Informal loans	7.03	3.88	2.26	5.24	11.07	4.14
From other sources	3.9	5.29	12.92	6.25	7.56	4.9

Source: InM 2016.

Table A. 11.3 Current Capital Structure

Capital Structure	Employment based groups			Sectors		
	<4 (lower ME)	5-9 (upper ME)	10-51 (S)	Trade	Service	Industry
Own resource	77.17	71.93	95.41	77.89	72.68	93.93
Partner's resource	0.26	4.78	1.23	1.62	0	0.3
Commercial banks	0.93	6.1	0.22	1.2	0	0.27
Loans from MFIs	12.87	9.76	2.05	11.31	20.4	2.83
Loan from cooperatives	0.1	0.05	0	0.07	0.73	0.02
Informal loans	3.11	1.66	0.41	2.06	0.91	1.62
From other sources	5.56	5.72	0.68	5.85	5.28	1.03

Source: InM 2016.

Annex 12: Matrix for Actions

Slno	Issue	Current State	Recommendation	Remarks
1	Policy on Development Finance	BB has no comprehensive policy.	Commission a study with strong in-house inputs to review all types of development financing policies & practices currently pursued by BB, and recommend a unified policy on development finance	It is assumed that development finance will be broadly grouped into two, targeted and non-targeted (all inclusive) programmes.
1.B	Policy on CmSME financing	What surfaced as SME financing policy during 2004-07, got articulated with years of practice in Master Circulars. These are more akin to operational directives and guidelines that are characteristic of targeted programmes. Targeting has been through inclusion principle – who are to be included among beneficiaries.	(a) As a regulatory authority in the banking sector, a general policy of targeted financing should be developed under the umbrella policy mentioned in (1) above. Beyond the inclusion principle currently pursued, such a policy may cover specifics on 'exclusion principle', as well as elements of programme design that attracts target population and discourages non-target population. (b) As a general principle, targeting through regular banking channel should not be a cause of concern for financial health of the sector.	Experiences from targeting in the fields of poverty and MF programmes may provide leads on the issues.
2.A	Definition for targeting mSMEs	Current practices in definitions are driven by the inclusion principle, and targets are defined in terms of value of fixed assets (excluding land and building) and employment. While Master Circular of 2016 retains the old segregation across three sectors, IP 2016 mentions of two, manufacturing and services. It is important to note, trade activities account for more than three-fourth of SME lending by banks.	(a) Undertake exercises to find proxies (correlates) from among variables which are commonly used by the practitioners in banking and FIs. Three variables worth considering for size classification within a given sector are: (i) turnover, which is used by lending agencies to assess clients' ability, (ii) value of collaterals that lending agencies take into cognisance, and (iii) loan sizes that reflect the former two variables. (b) With trading dropped from the list in IP, financing through mSME window is likely to lose momentum. Within the broader initiatives of financial inclusion, to expand the net of formal banking to micro and small clients and encourage MFI lending beyond IGAs, BB may consider opening separate windows, outside the purview of MOI. In this regard, joint initiatives with the Ministry of Commerce maybe looked into.	

Slno	Issue	Current State	Recommendation	Remarks
2.B	Setting cut-offs to classify mSMEs for financing in support of the Industrial Policy	BB aligns its SME financing with the IP. Accordingly, the definitions given in IPs have been passed on to the implementing banks and FIs. The latter do not necessarily adhere to the pre-defined targets, but compile information along those lines while reporting to BB for claiming benefits tagged to BB's SME financing policy	Since IP 2016 has been approved recently, no change in its content is expected soon. While pursuing with current practice, BB needs to examine the difficulties faced by implementing banks and FIs, and undertake exercises to find proxies in terms of variables mentioned in (2). The lessons may then be shared with MOI for converging to meaningful operational definitions for targeting. Furthermore, MOI may be urged to specify economic activities which should get benefits from incentivised financing, and activities that ought to be excluded.	The research team refrains from making specific recommendations since there are reports of significant differences between actual practices and those reported by lending banks and FIs.
3	'SME' financing to reach out to clients at the (extensive) margin.	While there had been natural growth of the MFIs into large loans, and MFI clients as well as lenders turning into micro and small entrepreneurs, commercial banks could extend their net to smaller clients allured by incentives under SME financing. In the absence of separate treatment of the expansion of financial net, SME financing vehicle may have been over-used.	In order to maintain healthy expansion of the financial sector, BB may consider using different vehicles. However, such undertakings demand continuous monitoring and analyses of data, without necessarily tying to one set of definitions provided under SME strategy of MOI. Thus, undertake research and product development to reach out to entities in the immediate exterior of the current net of banking from two ends — commercial banks and the MFIs. (See also, 2.A.b)	While a targeted programme may aim at financial deepening within a group of existing clients, it generally involves bringing new clients in the net. Issues pertaining to financial widening and those involved in promoting a target group need to be distinguished.
4	Revisiting efficacy of policy instruments used in SME financing	Other than instructions and persuasions, BB resorted to several incentives to encourage banks and FIs to increase lending to SMEs.		
4.A	Refinancing	The lending organisations were offered @ 5% annual interest rates. No binding was imposed on rates they charged while lending to their clients. The expectation of a 10% or less interest rate to borrowers did not materialise unless stipulated in a scheme.	(a) At an operational level, lower interest rates (below the rates at which banks can borrow from the market or average cost of fund) have to be offered to ensure participation by banks and FIs in targeted financing. (b) Since the market did not automatically ensure transmission of incentives via lower interest rates, it needs explicit mentioning, along with information made available to potential clients.	Reduction in banks' cost of fund does not guarantee lower lending rate. Unless cost of monitoring is reduced, objectives of refinancing are rarely realised.
4.B	Loan provisioning	General Provision @ 0.25% against all unclassified loans of SMEs has	An urgent review of the policy (of reduced loan provisioning) may reveal the cost to outweigh	

Slno	Issue	Current State	Recommendation	Remarks
		been the major attraction, which is alleged to have adversely affected the financial health.	the benefits, in which case, alternative policy instrument should be sought.	
4.C	SME service centres (since July 2011)	Beside reaching out to distant clusters, the policy had allowed the banks to move into dense urban clusters, which remained out of reach due to the policy on required distribution of branches (1:1 since 2012).	No specific recommendation is made other than to review the experience, which may lead to firm decisions on applications made by various banks to convert SME service centres to branches.	Decision is reported to be pending on various applications.
5	Systemic changes to create favourable environment for financial transactions via bank accounts			
5.A	To make Credit Assessment practices of Commercial Banks mSME-friendly	Commercial Banks are assessing credit capacity of borrowers mostly on the basis of Bank accounts, since lending policies of banks are designed accordingly.	1) BB may suggest banks to develop mechanism to accept cash transactions in credit analysis. Accordingly BB may prepare guidelines for banks to accept non-banking cash transaction in the turnover calculation. 2) Borrowers must be given correct product solutions to transact via Bank accounts, which will help them to establish their turnover to banks.	Commercial Banks to be encouraged to seek deposit relationship with mSMEs and use cash flow rather than asset ownership as a criterion for creditworthiness.
5.B	Establish/develop complementary institutional network and services to promote mSME financing.	Currently there is limited number of Credit Guarantee scheme operating in Bangladesh for mSME segment. Also there is inadequate Training Facilities and Business Development services for SME Bankers & mSMEs (Entrepreneurs)	BB may take initiative to offer Incentive programs to develop institutional network for mSMEs e.g. Financial and Credit guarantee institutions, business development services, training etc	These schemes are structured to reduce the probability of default of the debt and increase NPL recovery. The objective can be to facilitate Banks with additional comfort in mSME lending.
5.C	Use of Moveable Collateral as a substitute of Fixed assets	Banks are accepting only fixed assets i.e. land & building of mSMEs for secured loans.	BB can develop a clear rule for moveable property to be used as collateral under any forms of secured financing. A collateral registry for all moveable assets is required to reduce dependency on fixed assets.	Due to the limitation of options for secured financing, both banks and mSMEs, will be able to lend more by the introduction of moveable assets as collateral.

Annex 13: ERG Survey Questionnaire

Economic Research Group

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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 Bank and Financial Institutions Division (BFID) 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.

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