
The SME Missing Middle Problem in Developing Countries and its Link to Lack of Financing: The Case of Bangladesh

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This document represents part of the author's study programme while at the School of International Development and Global Studies. The views stated therein are those of the author and not necessarily those of the Institute.

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List of Acronyms

ADB Asian Development Bank

BASIC – Bangladesh Small & Cottage Industries Corporation

BB: Bangladesh Bank

BBS Bangladesh Bureau of Statistics

BDT Bangladeshi Taka

BSC Bangladesh Small Industries and Commerce Bank Limited

CSES: Centre for Strategy & Evaluation Services

CPD Centre for Policy Dialogue

DCED Donor Committee for Enterprise Development

EG- Edinburgh Group

ESCAP: Economic and Social Commission for Asia and the Pacific

EPZs : Export Processing Zones

GDP: Gross Domestic Product

G20 - Group of Twenty

GNP Gross National Product

ICG: International Consultancy Group

IFC International Finance Corporation

ILO International Labour Organization

IP: Industrial Policy

ISR – Industrial Sector Reform

MENA – Middle East and North Africa

MoFA Ministry of Foreign Affairs

MoF Ministry of Finance

MOI: Ministry of Industries

MIDAS – Micro Industries Development Assistance and Services

NGO Non-Governmental Organization

OECD Organisation for Economic Co-operation and Development

PI Proto-industrialization

PPP Public-Private Partnership

PSD Private Sector Development

R&D Research and Development

RMG: **Ready** Made Garments

SEAF: Small Enterprise Assistance Funds

SME Small and Medium Enterprise

UNCTAD: United Nations Conference on Trade and Development

UNDP United Nations Development Programme

UNIDO –United Nations Industrial Development Organization

USD - US Dollars

VCD Value Chain Development

WB World Bank

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Abstract

There is an increasing attention in the development literature on the issue of the Small and Medium Enterprises (SMEs) “missing middle” - a distinctive distribution of small and medium enterprises in developing countries as well as certain characteristics unique to this distribution. In this distribution the number of SMEs is found to be “low” relative to other enterprise sizes. A number of reasons are cited for the existence of this missing middle. They include: restricted access to Financing & Financial Infrastructure; Government Regulations & Taxes; Access to Electricity (particularly Energy); Economic & Political Uncertainty; and Lack of Workforce Skills & Informal Competition

The objective of this paper is to analyse whether there is a SME “missing middle” in Bangladesh and if so, are financial constraints a crucial factor for this. The paper also analysed the impact of various non – financial constraints on SMEs in Bangladesh. The paper is based on existing literature and available quantitative data and surveys from various international and local institutions and researchers.

The paper finds that there is indeed a SME “missing middle” in Bangladesh in terms of their number and their contribution to GDP and employment relative to similar contributions by the SMEs in the emerging and the developed economies. The paper concludes that the major causes for the SME “missing middle” in Bangladesh are a continuing lack of access to financing (even though there have been signs of improvement in this area) and infrastructural problems particularly access to power. The analysis also shows that SMEs in Bangladesh have diversified significantly overtime, going beyond what would be expected in a proto-industrialization process, and venturing into industrial sectors unrelated to the agricultural sector. The paper concludes that even though various pro- SME growth initiatives are underway, there is still room for improvement particularly in the provision of financing and in the adaptation of new and innovative ways of doing business.

Chapter 1: Introduction

1.0 Context

Small and medium enterprises (SMEs) are defined as non-subsidary, independent firms employing less than a certain number of employees. This number of employees varies from country to country (Ayyagari, Beck, Kunt, 2007).

SMEs constitute from 95 percent up to 99 percent of all enterprises and is one of the most dominant forms of business organizations (EG Report, 2012; & OECD, 2006). Most of them are family based enterprises, a small portion is equity based (of various types) and a tiny number are listed on secondary stock exchanges. SMEs contribute to (i) economic growth, (ii) increasing wealth by generating income and offering a variety of services and products and (ii) generating employment (much more so than large enterprises). This is more true if the retail and service sector are included.

The OECD has recognized the importance of SMEs based on the OECD economies 'experience since the early 1980s, esp. in Japan and Western Europe. H. Schmitz (1992), and others (including Piore and Sabel (1984)), extensively studied idea of "flexible specialization" where SMEs with similar characteristics can achieve sectorial concentration and address competition cooperatively. This concept suggested that SMEs intentionally confining themselves to similar localities, had the ability to shift their business process from the Fordist approach (of mass production), to a more flexible and adoptable productive regime (Edinburgh Group Report, 2012) and (Turner, 2000). The idea became more relevant when the Fordist mass production system faced severe obstacles due to unstable world markets, mainly during the global recessions of 1970s and 1980s (Turner, 2000) and enterprises needed to find an alternative organizational paradigm.

The flexible nature of the SMEs, and large labour surplus' in developing countries have meant that SMEs have emerged as a strong driver of international competitiveness in these countries (Schmitz, 1992). The SME flexible production and specialization paradigm also highlighted that SME clustering is crucially important for developing countries. Although there is a variance in growth patterns of clusters, there was a consensus that clustering enabled SMEs to better participate in international markets and better recover from externally induced growth constraints (Schmitz & Nadvi, 1999).

1.1 Statement of the Problem:

Industrial structures in most developing countries are characterised by a missing link or a missing middle. The ‘missing middle’ is a term used to refer to a distinctive distribution of small and medium enterprises in developing countries as well as certain characteristics unique to this distribution.¹ In this distribution the number of SMEs is found to be “low” relative to other enterprise sizes.

Industrial structures are normally in the shape of a pyramid. At the top of the pyramid, there is a small group of large domestic and foreign firms (public or private). At the bottom of the pyramid, there is a large informal economy made up of petty activities and micro enterprises. In between the top and the bottom of the pyramid, the number of formal sector SMEs is generally very small, and even absent in some manufacturing and services sectors. In addition, a major challenge facing the SMEs is their informal nature (Schmitt & Stephan & Zehdnicker (2002). This informal nature can cause the problem of “missing growth link” or the “missing middle” (Klinger & Khwaja & Carpio, 2013)

Many authors (Schiffer & Weder, 2001), (Sarder, J 2001), (Weiser & Wiebe, 2003), (Mintoo, A.A , 2004), (Tambunan, T, 2008c), (Chowdhury & Ahmed, 2011), (M.M . Rashid, 2012), (Chowdhury & Azam & Islam, 2013) suggest that the lack of financing is one of the most important reasons responsible for the “**missing middle**”. As SMEs grow, they find themselves to be too large to be financed through micro-financing but too small to access full collateral based commercial financing. In addition, the heterogeneous nature, absence of systematic business track records, and the lack of “bankable” collaterals of the SMEs deny them access to financing from the formal banking sector. This creates a SME financing gap, which acts as a constraint to SME Growth.

1.2 Research Objective:

This research paper will analyse whether there is a SME “**missing middle**” in Bangladesh and if so, are financial constraints one of the main reasons for this. This research will provide an understanding of the SMEs in Bangladesh. The analysis will be primarily based on existing literature and evidence

1.3 Research Question:

Is the concept of the “missing link” applicable and relevant to the development of the SMEs in Bangladesh? If so, is the lack of financing a major reason?

¹(This term was devised by the Centre for International Development, Harvard University.
Azfar Khan Course – DVM 6998: Supervisor: Philippe Regnier SIDGS, University of Ottawa

1.4 Sub-Questions:

Question for analysis: Does a uniform definition for SMEs exist globally?

Question for analysis: Is there a disparity in the causes for the “missing link for growth” between SMEs in developed and developing countries.

Question for analysis: What are the constraints of the missing middle in developing countries?

Question for analysis: Does the idea of “missing Link for Growth” apply for SMEs in Bangladesh? – If so, is the lack of finance a major cause for it?

Question for analysis: What has been done and what should be done by the government to fix the “Missing Middle” for Bangladesh if Present?

1.5 Research Methodology:

Data Analysis: - The data analysis would be narrative analysis from various articles through literature review.

The analysis will be based on desk research and secondary data from professional sources such as sources, from journals, newspapers, institutional reports, ILO, Bangladesh Bank reports, ADB, DCED, etc., that is specifically devoted to the SME sector. Various articles and literature in this context will be reviewed.

Ethics: The paper will follow all the academic integrity and regulations of writing a major research paper under the University of Ottawa. This major research paper consists solely of “desk research” and therefore does not include contact with other people as part of the research process. Therefore the ethical issues will not go beyond the academic regulations.

1.6 Organization of the Paper:

The paper will consist of 4 major elements

1. **A literature survey** of the nature and socio-economic contributions of the SMEs in developed, developing and emerging countries. The analysis will explore various definitions of SMEs in order to identify an appropriate definition of SMEs for Bangladesh. Adoption of an appropriate definition will help gain a better understanding of the “missing middle” concept in the context of Bangladesh. This will be done in Chapter 2
2. **An analysis** to find out if there is a missing link component for the SMEs in the manufacturing sector in Bangladesh, and if so, what is its nature. A further avenue of exploration will be to what extent these SMEs are affected by the underdeveloped state of the Bangladesh economy. For example, are registered manufacturing SMEs limited in number (as would be typical in a low-income economy like Bangladesh? Are they in very limited number of sectors (such as garments, agro food processing, leather)? This will be done in Chapter 3
3. **An exploration of the various constraints** responsible for the existence of “missing middle” in Bangladesh and their impact and relevance will be shown in Chapter 4
4. **Recommendations** to fix the “missing middle” problem will be provided in Chapter 5

Chapter 2: Importance of SMEs for Development

2.0 SME Definitions

Arriving at a uniform definition of Small and Medium Enterprises (SME) can be quite an overwhelming task. The criteria and threshold for the definition are different between developed and developing nations; the most common criteria used are based on employment, turnover and even assets. Various country policies and economic sectors shape the definition as well.

What are SMEs? "Analysts use varying definitions of SMEs. Many advanced countries define SMEs as firms employing between 10 and 250 workers (or, in some countries, 500). SMEs are generally viewed as occupying the middle of the firm size distribution. - Larger (and typically more formalized) than "micro enterprises, which are usually informal units employing at most a handful of people. In many small and less-developed countries, it should be noted, firms employing 250 or 500 people could well be among the larger firms in the country". (Beyond Microfinance), Policy Brief Ferranti & Ody, 2007, Pg., 2

Lindner, (OECD, 2004) explains that over time various practices have been used across countries. In the United Kingdom, Greece and Mexico, the definition threshold is based on the number of employees only. In Canada, the emphasis is on revenue. Portugal uses a mixture of both turnover and number of employees as defining criteria for SMEs. A Centre for Strategy and Evaluation Services report (CSES, 2012) evaluating SME definitions from many perspectives reported a definition recommended by the European Commission for its member countries in 2003. The recommendation incorporated the number of employees, net turnover and balance sheets. This definition is different from its previous recommendation in 1996, when micro enterprises were not included. The OECD (2004) report however suggests that distinctions should be made between micro, small and medium sized enterprises for better targeting.

There have been inconsistencies in defining SMEs between various multilateral and bilateral institutions. The World Bank defines a small enterprise as having a maximum of 50 employees but extends the limit to 300 employees for medium enterprise while allowing for an asset and sales limit of 15 million euros each (OECD, 2004). UNDP defines SMEs as having a maximum number of employees of 200. The Asian Development Bank uses individual national government definitions. A report by (Gibson & Vaart, 2008), suggests that the major multinational institutions should have the same rationale for their SME definitions and encourage similar practice for the Governments of individual nations.

A 2005 European Commission SME User Guide (2005) introduces 3 different categories of enterprises, Autonomous partnership (less than 25%), partner enterprises (would have a holding rising to 50%) and

above that bracket the SMEs are called linked SMEs. The User Guide points out that this definition is crucial for implementing proper programs and means to support the prosperity and development of SMEs. However two years later in 2007 the European Commission Report, defined SME in a range of up to 50(small) and in between 50-250(medium) employees, with an annual turnover equal or less than 50 million euros.

Ardic & Mylenko & Saltane (2011) undertook a cross –country analysis to understand the differences in the small and medium enterprises data. The report obtained country SME definition criteria from 68 countries, and found that almost 73% (50 countries) use the number of employees as the main criteria. 60% of the 50 countries used other criteria such as maximum turnover & maximum loan size. However, the disparate nature of SMEs in different countries has made it very difficult to arrive at a global definition. For example, Azerbaijan considered enterprises with maximum 5 employees as an SME, where else for the Republic of Korea, the maximum number of employees could be as much as a thousand employees.

2.1 Poverty Reduction and the SMEs

2.1.1 SMEs and Economic Growth

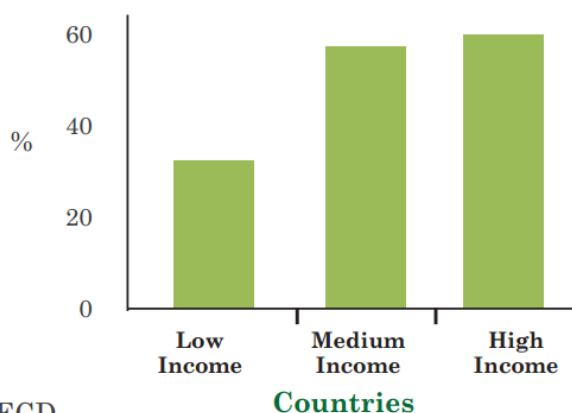
The Industrial Revolution was a vital turning point for global economic development and the era when the manufacturing sector became a critical element in explaining patterns and rate of growth (UNIDO, 2013). Large enterprises and manufacturing industries were for many years' international marvels and main drivers of global economic development. (Zhu,L.,& Li, N., &Huang,J.,2012).

However, a growing body of literature is now emphasizing the importance of small and medium enterprises (SMEs). This “resurgence” can be traced to the idea of “flexible specialization” by Piore and Sabel (1984), where SMEs with similar characteristics can achieve sectorial concentration and address competition cooperatively (Schmitz, 1992). This concept suggested that SMEs intentionally confining themselves to similar localities, had the ability to shift their business process from the Fordist approach (of mass production), to a more flexible and adoptable productive regime (Edinburgh Group Report, 2012);&(Turner, 2000). The idea became relevant at a time , when the Fordist mass production system faced several obstacles due to unstable world markets, mainly during the global recessions of 1970s and 1980s (Turner, 2000) and enterprises needed to find an alternative organizations paradigm. This concept was originally rooted in the study of structure & nature of small industries primarily in certain districts of Italy, and was then extended to other European countries and the rest of the developed world (Morris & Lowder 1992). Subsequently it was found that the informal nature and flexibility of small firms in Italy very closely reflected the behavioural and business patterns of the SMEs in developing countries (Turner,

2000). The flexible nature of the SMEs, a strong inter- firm division of labour and large labour surplus' in developing countries have meant that SMEs have emerged as a strong driver of international competitiveness (Schmitz, 1992).

First ranking competitive economies such as Germany or Switzerland, Japan, capitalize on two pillars (one made of large firms, a second made of highly specialized SMEs). In OECD countries, or the developed economies, SMEs account for 60 % of employment and 50 % of GDP (their direct and indirect contribution to exports is also important: for instance, SME direct contribution to Korea's total exports is between 35 and 40% (OECD, 2004). But this is not the case for SMEs in developing and even surprisingly for some emerging nations. For low income countries, SMEs account for only 30 % of employment and 17% of GDP (Table 1). A widely spread hypothesis is that SMEs can play a key role in employment creation providing two thirds of all formal jobs in developing countries and up to 80 per cent in low income countries. (Kok &Deiji &Essen, 2013)

Figure 1: Contribution to Employment of the SMEs



Source: OECD

In addition, while SMEs represent the bulk of existing enterprises in most countries, manufacturing and service sectors combined, in most developed and developing economies worldwide, the number of SMEs in the formal economy is limited in low income economies, and sometimes hardly existent in some sectors (manufacturing in particular).

2.1.2 Impact of SMEs on Poverty Reduction

The Private sectors, including the small and micro enterprises, have had a major role to play in global poverty reduction (Vandenberg, 2006). The International labour Organization elucidates the dual criteria of SMEs in not only creating income and wealth but also employment and work. Apart from creating prosperity from poverty, SMEs are recognized for their contribution in sustaining global economic recovery (Rabbani & Sulaiman, 2005) & (OECD, 2006)., SME continued to be the main employment generator of the European economies employing around 87 million people (Wymenga, & Spanikova & Barker & Konings, & Canton, 2012) in an environment of sovereign debt crisis and global recession..

The World Bank Review on Small Business Activities establishes the commitment of the World Bank Group to the development of the small and medium enterprise (SME) sector as a core element in its strategy to foster economic growth, employment and poverty alleviation. Since the 1990s, private sector development has become a top priority for most OECD donor countries. Aid for private sector development is now US\$24.5 billion and increasing. (DCED, Synthesis Note, Sept 2013).

SMEs play a supportive role in the production value chain both for domestic and international businesses by taking sub- contracts from the large scale enterprises (ADB 2012). Shinozaki (2012) found that there is a critical intensity of competitiveness amongst the SMEs giving rise to innovative products and services. This helps especially in the area of Intra- regional trade and manufacturing to foreign markets. Also the formation of SME clusters, i.e. a number of firms working together, to create and take advantage of mutual service facilities, aiding each other in sales, production and work in progress, has helped the SMEs to provide consistent sound performance even during the Asian financial crisis in 1997/1998 (Shinozaki, 2012). There are several layers of SME subcontracting, but it varies from one sector to another.

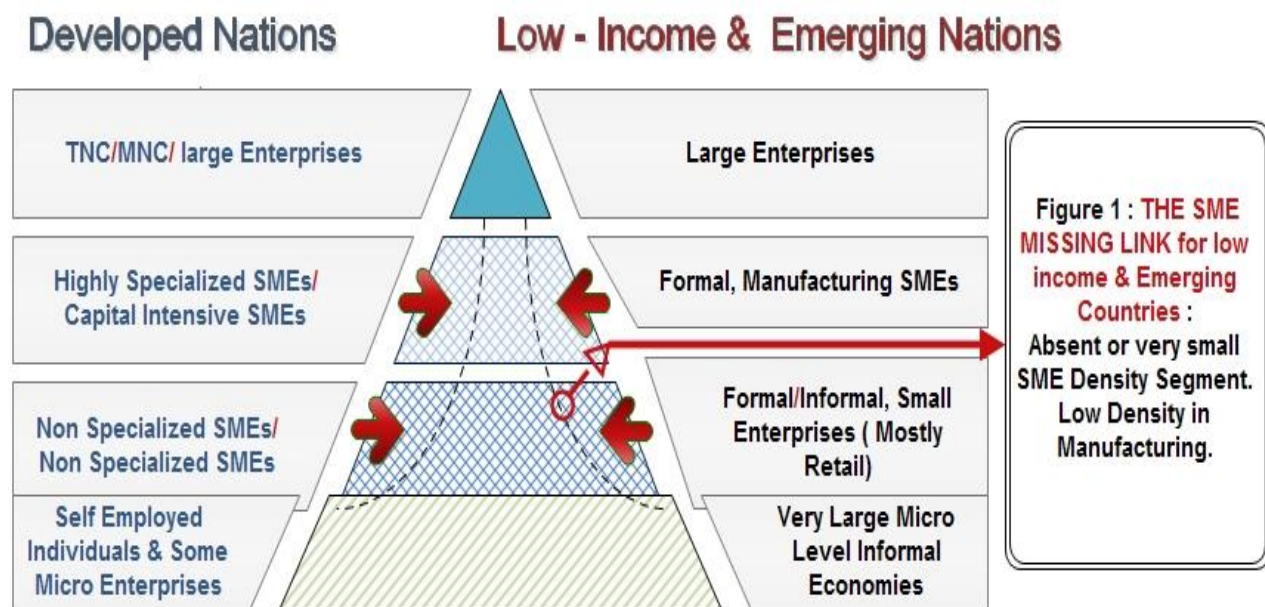
Fields (2011) point out that private sector employment is much more prominent in developing countries with only one out of ten workers working in the public sector. However, most private sector participants are not registered and do not benefit from business support programs offered by the Government (Fields (2011)). This is because of the predominately informal nature of the SMEs in many developing countries. This informal nature leads to a wide variety of working patterns and behaviours, for example employment in the form of workshops, as a piece by piece system, or even without any automation, etc. (Fields, 2011). They also include working activities that are seasonal or cyclical, from ice cream vendors during summer, to snow removal in the winter. They also include employment contracts, ranging from hourly to day-to weekly basis. Masato (2009) also finds evidence of informal networking between informal family enterprises and corporate sector which is very formal in nature.

Some SMEs, export their goods and services, and bring in foreign exchange earnings for the respective countries. According to the Small Enterprise Investment Funds (SEAF)², SMEs have had a much wider multiplier effect, compared to investments in micro establishments or even for investments in large multinational corporations. For an emerging economy, an investment of 1 dollar in SMEs creates a ripple effect of \$ 10 (Poverty Cure, 2013)³

2.2 The Missing Middle Problem

A global SME survey by Ayyagari, Beck & Kunt (2007) validated the significant variation in the growth structure of SMEs between the high-income countries and the low income countries as illustrated in Figure 2.

Figure 2: Mapping the Enterprise Structure of a National Economy: Illustration of the SME Missing Middle Illustration⁴



The pyramid structure for the low income to even emerging market economies (marked by dotted line), shows that small and medium enterprise segment is absent or very small. The density or number of SME

²Investment management group that provides growth capital and business assistance to small and medium enterprises (SMEs) in emerging and transition markets.

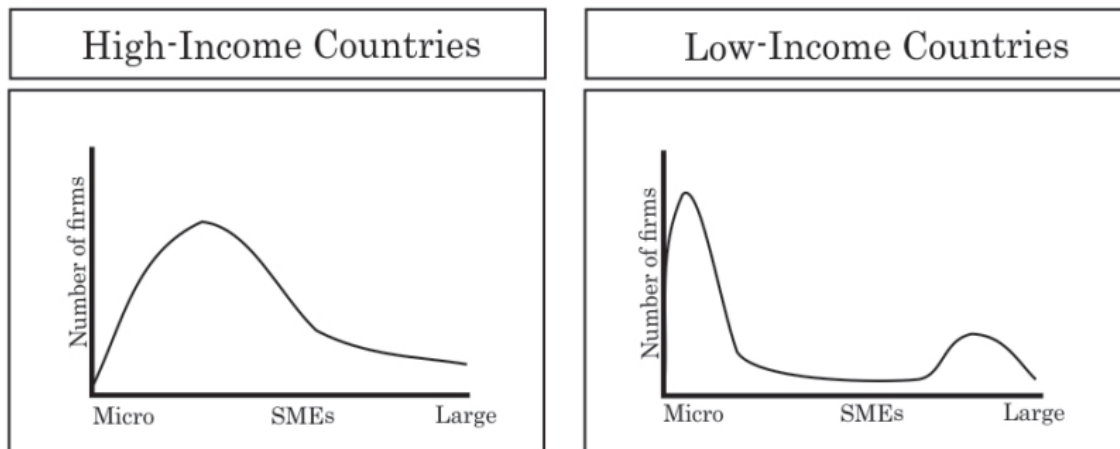
³ Poverty Cure you tube video on “Missing Middle” <https://www.youtube.com/watch?v=mqWPcCLG6Vk>
<http://www.povertycure.org/media/blog/beyond-microfinance-addressing-the-missing-middle/>

⁴ Author composed after reviewing literature

in manufacturing is likewise also rather inadequate. This limited presence of SMEs in low income countries is often termed as the “The "Missing Middle / Missing Link.

Figure 3 illustrates the resultant distribution of enterprises by size in the low income countries in comparison to the distribution in the high-income countries.

Figure 3: The "Missing Middle/ Missing Link



Source: Centre for International Development, Harvard University

It is clear that the proportion of SMEs in low income countries is much smaller. Most enterprises in these countries tend to be microenterprises often fostered and encouraged by the microfinance institutions. These businesses have lifted families out of absolute poverty. However for further progress, it is necessary that they can graduate to the next level and become SMEs. It will be necessary to address the “missing middle” / “SME missing link” problems if this is to be achieved.

2.3 Factors responsible for the Missing Middle

Table 1 is a compilation of conclusions from 11 surveys, undertaken by various specialists and authors, studying the constraints on SME growth and development around the world. The respondents in these surveys come from developed as well as developing countries from various regions including Asia, Europe, the Middle-east and North- Africa. These surveys provide a very useful snapshot about the constraints to SME growth.

Table 1: Various Worldwide Surveys, on Growth Barriers for SMEs

“Missing Middle” Constraints				
Sr. #	Source	Name of Survey & Year	Respondent Focus	Top 4 Barriers? Challenges for SME Growth? Clients
1	Edinburgh Group Report, 2012)	IFAC SMP Quick Poll 2012, ⁵	Worldwide	<ul style="list-style-type: none"> • Burden of regulations • Economic Uncertainty • Rising Costs • Difficulties accessing finance
2	(Prasadila,2010) ADB working paper	The Business Environment and Enterprise Performance Survey (BEEPS), 2005 ⁶	27 countries in 2005 (Mostly Eastern Europe and Central Asia)	<ul style="list-style-type: none"> • Tax Rates • Tax Administration • Cost of Financing (interest rates) • Corruption
3	Global Entrepreneurship Monitor Report, 2013,	Entrepreneurship Framework Conditions Main Indicators, 2013	(Worldwide, 69 Economies)	<ul style="list-style-type: none"> • Entrepreneurial Finance.⁷ • Government Policy. • Government Entrepreneurship Programs • Entrepreneurship Education.

⁵From <http://www.ifac.org/sites/default/files/publications/files/IFAC-SMP-Quick-Poll-2012-Round-Up.pdf>

⁶ From <http://ebrd-beeps.com/about/>

⁷ The availability of financial resources-equity and debt-for small and medium enterprises (SMEs) (including grants and subsidies).

4	(Shinozaki, 2012) Asian Development Bank Paper	(IFC) 2010 stocktaking report on SMEs to the Group of Twenty (G20)	Asia	<ul style="list-style-type: none"> • Restricted Access to Financing. • Other factors : <ul style="list-style-type: none"> • Lack of skilled workers • Fragile internal control systems, • Management culture
5	Kuntchev & Ramalho & Meza & Yang, 2013)	The World Bank Enterprise Survey, 2013	Worldwide 116 countries	<ul style="list-style-type: none"> • SMEs are more likely to be credit constrained than large firms • Credit Constraint Status (World Data) • Fully Credit Constraint: 17% • Not Credit Constraint : 38 %
6	European Central Bank	Survey on the access to finance of SMEs in the euro area (SAFE) October 2013 to March 2014 update	Countries of European Union. 7,520 firms	<ul style="list-style-type: none"> • While access to finance remains an important concern, it is less important than finding customers or the cost of production or labour.
7	Ardic & Imboden & Latortue, 2013	I2012 Financial Access Survey (FAS) information taken Financial Access Survey, 2013	Annual data for 186 countries, (2004-2012)	<ul style="list-style-type: none"> • Access to Finance, • Funding Investments • Insuring Against Risk <p>Non-Financial : Infrastructure</p>
8	(Rocha & Farazi & Khouri & Pearce , 2010)	a joint survey of the Union of Arab Banks and the World Bank (The Mena Survey ⁸ 2010	Middle East and North Africa (MENA) region	<ul style="list-style-type: none"> • Weak Financial Infrastructure • Weak, credit information • Weak creditor rights • Weak, collateral infrastructure.

⁸http://siteresources.worldbank.org/INTMNAREGTOPPOVRED/Resources/MENAFIflagshipSMEFinance12_20_10.pdf

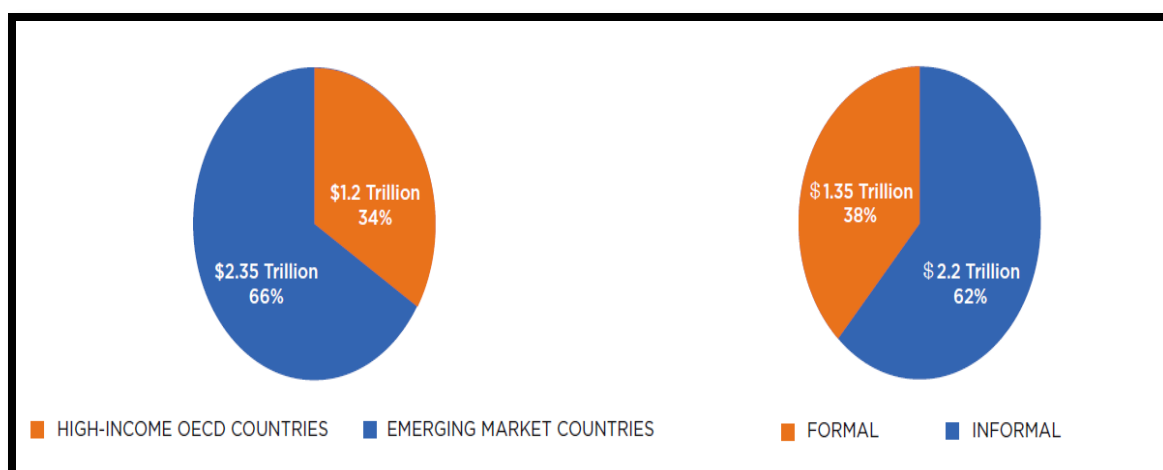
9	IFC and THE World Bank	The World Bank, Doing Business 2013	Regional Profile: South Asia (SA)	<ul style="list-style-type: none"> • Enforcing Contracts • Trading across borders • Getting Electricity • Registering Property
10	Schiffer & Weder, 2001, IFC,	Private Sector Survey, 2001	80 Countries Worldwide	<ul style="list-style-type: none"> • Financing • Taxes & Regulations • Inflation • Corruption

2.3.2 Analysis of the Global Surveys

Most European Union member countries, find attracting customers, as well as cost of production or labour as the main impediments to SME growth over access to finance. While access to finance is seen as a primary concern, a joint survey of the Union of Arab Banks and the World Bank further add weak financial infrastructure including weak credit information and weak creditor rights as constraining factors. For Asia and many similar emerging nations, the issue of uncertainty, mainly with government regulations (tax and interests) pose a problem for growth and development of SMEs. The IFC Private Sector Survey in 2001 and Doing Business Report 2013 covers 13 years of non-continuous data, where economic uncertainty mainly from the external environment⁹ is seen as great non-financial barriers to SME growth. Lack of Energy (Electricity) and presence of corruption were found to be the other limiting factors

A 2013 update on SMEs to the Group of Twenty (G20) survey cited in table 1 suggest that while many countries have already taken initiatives to recover quickly from the financial crisis, access to finance remains an important issue mostly for SMEs rather than large firms. However, there is substantial difference in the access gap between formal SMEs in emerging markets, and between informal sector and poor households. Figure 4 provides updated information regarding the SME finance gap (SME Finance Forum 2013).

⁹The external environment of an organization are those factors outside the company that affect the company's ability to function by George.N Retrieved from <http://smallbusiness.chron.com/five-components-organizations-external-environment-17634.html>

Figure 4: Total MSME Credit Gap, by Market Segment and Characteristics¹⁰

For low income countries, access to power (energy) is also a big constraint to the SMEs. Taxes, lack of workforce skills and informal sector competition are seen as other key constraints (SME Finance Forum 2013).

An important finding is that although restricted access to financing and/or lack of financing remains a major constraint, the severity of the access to finance problem has significantly reduced over while other constraints (SUCH as..) have become important.

The overall conclusions of the surveys are that the factors that impede growth and development for SMEs globally are as follows¹¹

- 1.0 Restricted Access to Financing & Financial Infrastructure
- 2.0 Government Regulations & Taxes
- 3.0 Access to Electricity (particularly Energy)
- 4.0 Economic & Political Uncertainty
- 5.0 Lack of Workforce Skills & Informal Competition

¹⁰ Figure 3 Source: IFC. 2011/2012 update

¹¹ This is not the exhaustive listing, but only based of the literature review and the surveys analyzed from the table.
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Chapter 3: SMEs in Bangladesh

3.1 SME Definition for Bangladesh:

The most authoritative definition for SMEs in Bangladesh is provided by the Industrial Policy 2010 (Table 2). It is authoritative because the definition discussed in the document has been endorsed by the Ministry of Industries, Bangladesh Bank as well as the Better Business Forum (BB Credit Policy).

Table 2: Definition of SME,

TABLE		(Small Enterprise)		(Medium Enterprise)	
SL	Sector	Fixed Asset other than Land and Building	Employed Manpower (Max)	Fixed Asset other than Land and Building	Employed Manpower (Max)
1	Services	50,000-50,00,000	25	50,00,000-10,00,00,000	50
2	Business	50,000-50,00,000	25	50,00,000-10,00,00,000	50
3	Industrial	50,000-1,50,00,000	50	1,50,00,000-20,00,00,000	150

Table 2: Definition of SME, Source : Bangladesh Bank, (Exchange Rate 1 CAD= 70.5 BDT, Accessed, April 12, 2014, (google.ca)

Another authoritative source of statistics for the SMEs in Bangladesh is the 2005/2006 Bangladesh Bureau of Statistics data for 84 thousand SMEs. The data revealed that on average, the number of employees present in a small and medium enterprise tended to be between 18-67 persons, (Ahmed, M.U, 2013). The range is similar to most South Asian countries where employment in SMEs tends to be between 49-100 employees. For Egypt, the number of employees for a small enterprise is between (5-14). For Ghana (6-29), and for Malaysia between (5-50) (Edinburgh Report, 2013).

Some authors ((Ahmed, M.U, 2013) consider that the definitions in Table 2 as too high in terms of employment for a developing economy, especially when compared to the OECD averages. Nevertheless, The definition in table 2 meet the need for a much needed uniformity in the definition for SMEs in Bangladesh.

3.1.1 A Background on the Definition Debate

While the importance of SMEs are well recognized for Bangladesh (by both the private sector and the Government), an effort to measure the number of SMEs in quantitative terms leads to a lot of difficulties. The problem is not only the non-availability of statistical information on a year to year basis, but also the problem of the wide variation of information available from different national agencies. For example, Ayyagari & Beck & Kunt (2007), a popular citation in this literature, analyzed the relationship between the relative size of the small and medium enterprises (SME) of 76 countries worldwide. However, the lack of available SME data eliminated Bangladesh from the inclusion of that list.

SME definition for Bangladesh was for a long time, unclear or constantly evolving through conflicting changes made by various organizations (Bangladesh Bank Policy Paper, 2008). Alam & Ullah, (2006) in their study of SMEs of Bangladesh, recommended the idea of a uniform definition of SMEs and pointed out that policy creation and implementation was not effective due to a lack of consensus of definition.

The 2008 Bangladesh Bank Policy Paper stated that private organizations as well as government institutions defined SMEs based on their preferences. Most of the variances in the definition were in terms of volume of invested capital and employment. They showed that neither Bangladesh Bureau of Statistics nor the Annual Economic Review of the Ministry of Finance showed (between the years 1999-2004) industrial statistics separating data for SMEs. The coverage was restricted to large and small industries only, whatever might be the definitions of these two categories.

The Bangladesh Bank, (BB) the central bank of the country defined SMEs in terms of investment and number of employees. The Bangladesh Bureau of Statistics (BBS) only took into consideration the number of employees. An important document called the Policy Strategies for Development of SMEs (2005) by the Ministry of Industries (MOI) of the Government of Bangladesh segregated SME definition by sectors, i.e. Manufacturing by value of capital, and non- manufacturing (sales and trading) defined by instances of active employment.

The MOI has been reviewing and testing the definitions of SME's from early 1990s to help in the formation of industrial policies and in synchronization with the evolution of Bangladesh's industrial structure. Major changes in the definitions are evident in the Industrial Policies of 1990, 1999, 2005, 2008 and 2010(Rahman, 2010). Over the years, there has been major emphasis on employment and capital size rather than the size of total fixed investments.

A UNDP South Asia workshop report (2004) emphasized that the Industrial Policy 1999 was the first policy to incorporate the breakdown of small and medium enterprises. Prior to that, the Industrial policy (1991) prioritized and categorized the market into large, small and cottage industry with the latter having an upper limit of Fixed Assets, of TK(50,0000) (Alam & Ullah, 2006). The “cottage” employer was mainly comprised of household based family labour, falling within the “small category.

The government of Bangladesh, created a comprehensive Industrial Policy in 2005 putting special emphasis on SMEs, to help with the challenges of free market economy and globalization .This industrial policy in 2005, made further segregations between manufacturing and non-manufacturing, enterprises. (Zaman & Islam, 2011) putting weight on identifying major financial constraints for SMEs in Bangladesh. It, however, made an important contribution by analysing Micro, SME and large enterprises by sectorial distribution. (Zaman & Islam, 2011) their report regarded manufacturing SMEs as (10-99) workers.

For the manufacturing SMEs, in Bangladesh, The latest Industrial Policy 2010, increased the number of workers from (10-50) (Industrial Policy 2008) to (25-99) workers. For the medium sector, it was raised from (50-150) (IP 2008) to (100-250) workers (Rashid 2012).

In the same year, SME and Special Programmes Department of the Bangladesh Bank, in a report titled “Small and Medium Enterprises (SME) Credit Policies & Programmes” divided the SMEs into “small” and “medium” and into 3 sectors i.e. Service, Business and Industrial sectors.

3.2 Proto- Industrialization: The Role of Agriculture as Engine of Industrialization

Mendels, (1972), first argued that the industrialization of Europe or the beginning of a machine industry, took place only after a rapid growth & economic change of a principally rural industry. This notion which he calls Proto-industrialization (PI) was previously used by J.T, Collins (1969) with Jones and Woolf, (1969) in studies of European agriculture. However, it was Mendels who introduced this concept, in the study of social and economic studies (Gullickson, 1983).

Mendel's reiterated that the role of agriculture especially "subsistence agriculture by peasants" in small farms, created a proto- industrializing effect, by creation of regional specialization, resulting in some regions turning to industry and others to commercial agriculture (Gullickson, 1983). This eventually created full industrialization "(factory production of goods for national and international markets) by creating "capital accumulation, market connections, entrepreneurial skills, and agricultural progress"¹².

His main arguments were:-

The rural domestic manufacturing has always led to the build-up of Proto- Industrial phase linking and empowering more peasant families (Hudson, 1990).

The transition of peasants to rich enriched peasants,¹³ when they were able to accumulate capital by switching from survival economies, to production surplus systems(Hudson, 1990).This was possible due to a better labour absorption capacity without any increase in land area (Sugihara, 2007).

An example would be that the rural peasant household would perform their "main" agricultural activity which was rice production. At the same time, other household members or hired labour would perform "additional" work, which would be "non- rice "cash crop production and proto industrial work (Sugihara, 2007).

They were able to save money, make profits, and purchase machineries, and factories. As a result, the peasant household had a better capacity to utilize their time, available labor and space (Mendels, 1972). This led to the rise of merchant behaviour and cottage industries, which eventually improved agrarian techniques and led to the emergence of large scale commercial agriculture, or more importantly in the direction of industrial capitalism (Hudson, 1990).

Mendel's model was illustrated during the late seventeenth to the early nineteenth century in West Europe, and a number of peasant handicraft skills, particularly metalwork's and textiles which was harnessed into commercial production. Other agri-based sectors that were considered to be proto-

¹² Mendels, "Proto-Industrialization,p"p . 241-46.

¹³ Being able to shift from survival economies to production surpluses.

industries dominating English and European markets during that time were cotton, lace, hosiery, glove making, & woollen production (Hudson, 1990).

Ahmad (2007) studied the effects of proto-industrialisation for Pre-colonial South Asia, particularly India. He studies broad patterns of production and exchange in pre-colonial India, and compared them with corresponding structures prevalent in Europe (Ahmad, 2007). Peasant families in Bengal, during the 1620s, were very much involved in weaving, spinning, and textile production in the form of rural enterprise and household production (Ahmad, 2007). Although the socio-economic conditions in India and Europe were not similar, he came to a cautious conclusion, that the gradual shifts of production, structures and strategies in India, were along the same pattern of development followed in Europe (Ahmad, 2007).

Mendel also stressed that The PI created radical cultural changes, For example, Proto-industrialisation in rural Japan had a clear impact on demographic behaviour. The sex ratio was corrected to the more natural level, and population grew substantially (Sugihara, 2007 & Hudson, 1990). Proponents say there was a greater power shift for women and children and a shift in traditional sex roles. Women were busy producing goods, while, men did housework, (Hudson, 1990). Some opposition argue that the traditional sex roles did not get substituted rather; manufacturing tasks got burdened on a expected female household along with her parental responsibilities (Hudson, 1990).

Mendels's concepts provide an interesting tool for analysis, which highlights important connections between industrial change, and the agrarian environment (Hudson, 1990). However, the application of this theory will depend on the context including different, labour, product and country needs.

Overall, the impact of proto industrialization has been realized (1500s to early 1900) in Eastern and Western Europe, America and Russia, China, and even West Africa (Perlin, 1983). The most interesting example is the rural reform in Taiwan during the 1950s-60s which resulted in the birth of numerous SMEs throughout the country (Taiwan being until today a country with the highest number of SMEs per number of inhabitants). Therefore this Proto – industrialization debate, poses an argument that it is a universal pattern for most countries, to have sub-regional specialization in more or less, 4-5 key sectors including the agro- foods sector.

3.3 Aggregate Sector Analysis:

3.3.1 Protoindustrialization in Bangladesh

Table 3 provides a sectorial breakdown of Bangladesh's GDP over the last 5 decades.

Table 3 Bangladesh : Gross value added in Agriculture, Industry and Services as a share of GDP at current Prices (1950-2005) Percentage

Year	Agriculture	Non-Manufacturing	Manufacturing	Services
1950	61	0	7	32
1960	57	2	5	36
1980	32	7	14	48
2005	20	10	17	53

Source: Adapted from Szirmai (2009) and Szirmai, Naudé and Alcorta (2013). Cited from UNIDO Report, 2013

It shows that Bangladesh evolved from an agrarian economy to a manufacturing and service sector based economy. The agriculture sector gradually diminished in importance, while other sectors expanded. This evidence is consistent with the normal process of economic development where, in the long run, countries become richer is not only via growth but also due to the transition from a lower to higher productivity sector (UNIDO, 2013).

Table 4: Bangladesh Sectorial Compositions: Percentage of GDP (1978-2009)

Year	Agriculture	Industry	Service
1978-79	44.9	18.2	36.9
1988-89	37.1	17.1	45.8
1998-99	25.3	25.7	49.0
2008-09	20	29.7	49.7

Source: Bangladesh Bureau of Statistics Yearbooks (Bakht & Yunus, 2011).

The Bangladesh Bureau of Statistics (BBS), the nation's national statistical research organization has been responsible for providing vital statistical information about the country via its statistical yearbooks. Table 4 shows that in 1978-1979 that the economy of Bangladesh was dominated mostly by agriculture based collections, which mainly included livestock, forestry, and most importantly, fisheries. (Bakht & Yunus, 2011). However over the years, there was a growth of the service sector and a gradual decline in the share of agriculture. The overall analysis of last 10 years, tells us that while the Industry sector has increased by 4%, the service sector, has only increased by 0.7%. Bakht & Yunus, (2011), highlights that the industrial sector held very marginal share compared with agriculture and service sectors at the

beginning, but there was a positive growth pattern observed over the period of (1978-2009). They further suggest that these changes, have been brought about by changes in public policies by the government, which promoted external liberalization and more private sector participation. This evident on GDP based sectoral distribution is consistent with the National Economic Census Report 2013, that more than half of the Bangladeshi labour force was engaged in economic activities outside the farm sector.

3.4 Potential Industrial Sectors

Bangladesh's major crops include: rice, wheat, oilseeds, spices, fruit, sugarcane, potatoes, pulses, beef, milk, and poultry.¹⁴ Rice, with an average 70% share of the gross output value of all crops is the leading crop. While Agriculture is one of the driving forces behind economic prosperity in Bangladesh, the share of agriculture in GDP has gradually decreased from the 1970s. The share of livestock and fisheries & livestock on the other hand has increased steadily in recent years to 22% of the value added in agriculture.¹⁵ (Canadian Trade Commissioner Service, 2010)

Agribusiness has achieved limited success in a few areas, including dairy products, vegetables, wheat and bakery products poultry, shrimp, fruits, medicinal plants, animal feed, flowers and orchids. Other commodities and products including rice, tea, sugar, jute and tobacco have been part of the commercial system of production, but have not shown yet the required dynamism to become successful agribusinesses. (Canadian Trade Commissioner Service. 2010) Many local companies have now moved in to agri-food business and have used supply chain management to maintain a farm to retail sales direct linkage. (Canadian Trade Commissioner Service, 2010)

Rice, the largest agricultural sub-sector is still dominated by a large number of farmers producing for household food security or producing for a small marketable surplus. One example is that PRAN, a local company is producing aromatic rice. However, there is a scope to improve the milling, packaging and distribution capacity.

A special 2004 series of documents prepared by Bangladesh Enterprise Institute¹⁶ highlights four subsectors for SMEs i) Agro-tools, ii) Plastics, iii) Pond Fisheries, and iv) Vegetables. The Report provides data from 2004, and is primarily productivity mapping study,

¹⁴ Canadian Trade Commissioner Service. 2010)

¹⁵ <http://www.ats-sea.agr.gc.ca/asi/4578-eng.html>

¹⁶ Bangladesh Enterprise Institute is a non-profit, non-political research centre focusing on the growth of private enterprise in Bangladesh.

Table 5: Growth Rate of Industry Sectors: (Constant Prices of 1995-1996)

Year	Small and Cottage Industries	Medium to Large Industries
2004-05	(7.93)%	(8.30) %
2005-06	(9.21)%	(11.41) %
2006-07	(9.69) %	(9.74) %
2007-08	(7.10) %	(7.26) %
2008-09	(6.90) %	(6.58) %
2009-10	(7.77) %	(5.98) %
2010-11	(5.84) %	(10.94) %
2011-12 (Provisional)	(7.18) %	(10.78) %

Source : BBS statistics, from Bangladesh Economic Review, 2013

Table 5 shows the growth of small and cottage industries as well as the medium to large industries for Bangladesh. The data fails to segregate growth patterns between manufacturing sector and the small and medium sector industries, therefore, making it difficult to realize the true potential of small and medium scale enterprises. (Chowdhury & Ahmed (2011) showed similar data, breaking down the growth pattern into SME and manufacturing sector. Using Bangladesh Economic Review data from 2008-2009, they specify that the manufacturing sector is growing and contributing substantially to the increasing economic growth (BD Econ Review, 2013). According to BBS estimate, manufacturing sector contribution to GDP has been estimated at 31.26 percent (BER, 2013).¹⁷

The Bangladesh Economic Census 2013 did not give an exact breakdown of small and medium scale enterprises and the large enterprises. The Preliminary Report (2013) reported a rapid growth in total economic units in the past decade and similar to its 2001 & 2003 edition focused more on economic units by the geographical distribution in the division and districts of the country. However an important finding is that the informal sector has seen quite an expansion of growth in the last 10 years, and is considered an important part of the growth dynamics.

¹⁷ Other two important sources of information on SMEs in Bangladesh are the annual economic review from the Ministry of Finance and data from Bangladesh Bureau of Statistics (BBS). The coverage of the annual national economic reviews are, however, restricted to Large Enterprises and Small Enterprises in manufacturing industry, whatever might be the definitions of these two categories. (Tambunan, 2008).

Another important source of SME information is the Private sector development chapter of Bangladesh Economic Review report 2013. The demand for private investment is growing and The Board of Investment (BOI) of Bangladesh acts as a state sector agency for advice and business help, for local private enterprises (BER, Private Sector, 2013). However BOI- registered local enterprise statistics are not available and only survey results gave the following, road map.

Figure 5: Local Investment Projects, by Sector (Registered with BOI, 2011-2012)

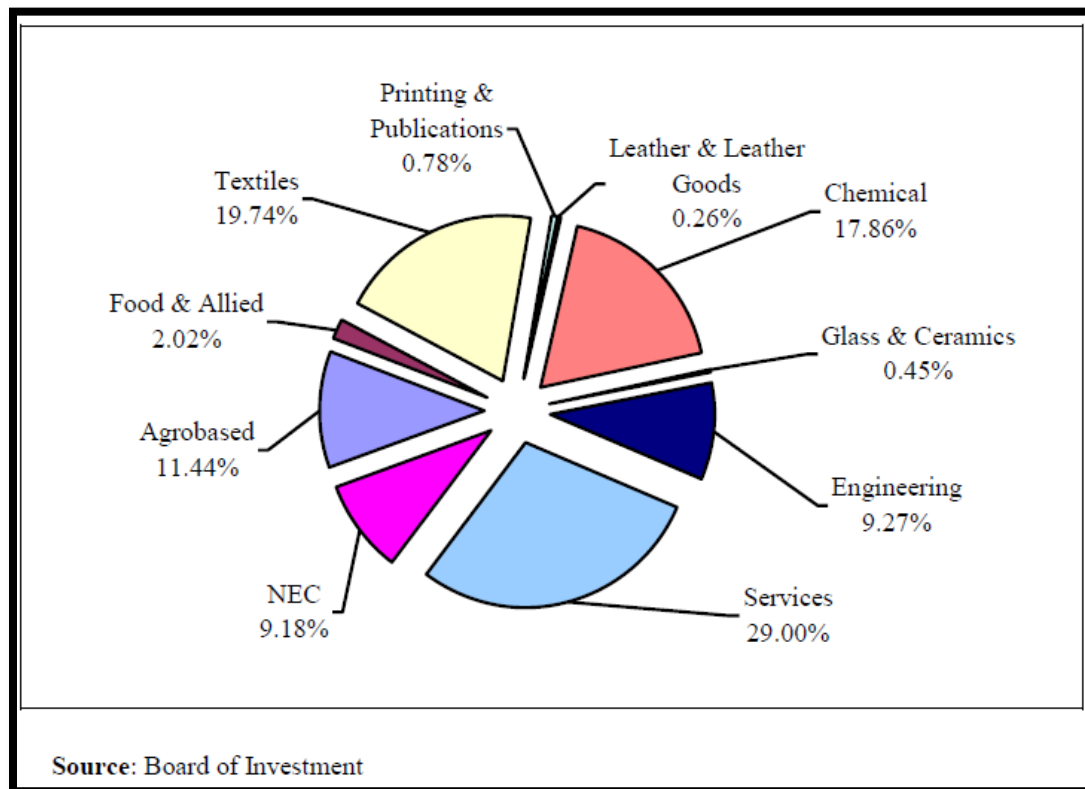


Figure 5 illustrates that service sector still captures a good chunk of local investments. While leather and Leather goods, have dropped as a percentage, compared, Chemical items, and Textiles, and Agro based products, and have seen healthy investment increases.

A 2013, Diagnostic Trade Integration Study on Bangladesh by World Bank Study points to some upcoming potential trade sectors of Bangladesh. They are,

1. Ship building:
2. Light Engineering: Bicycles
3. Light Manufacturing: Diversified Jute Products
4. Light Manufacturing: Non- Leather Footwear
5. IT Enabled Service

6. Apparel Sector: Polo T Shirts
7. Pharmaceutical Sector.

The shipbuilding sector in Bangladesh has recently shown increased activity and potential as a future growth area. Light Engineering in the form of Bicycle production is seen as an emerging export product for Bangladesh comprising to about 7.5 % of all engineering exports. Bangladesh ranks seventh among the top ten footwear producers worldwide in terms of quantity (276 million pairs in 2011). The important thing to note here is that this was with the presence of a large number of small and medium enterprises in this sector with a few large firms (World Bank, BD, Sector Study, 2013) Jute is also an important sector where Bangladesh is the second – largest producer in the world. Jute and jute products constitute 60% of Bangladeshi agriculture exports, and were 3.8 % of all exports, in 2012/2013.

3.5 Analysis of Specific Sectorial Distribution of SMEs

There are two major publications describing the magnitude and distribution of SMEs in Bangladesh. - M.U, Ahmed (2006), and Minto (2004). However, both authors emphasize the lack of accurate information available for SMEs in Bangladesh due partly to the highly diverse and heterogeneous nature of the SMEs. The available statistical information about the SMEs does not have an institutional level consensus (Islam & Mian & Ali, 2009). For example much of the statistical work does not have data on SMEs per se but on small scale industries only.

M.U.Ahmed (2006) and Minto, (2004) based their conclusions on two main surveys,

1978 – Survey by BSCIC (Bangladesh Small and Cottage Industries Corporation)¹⁸ & Ministry of Industries (MOI)¹⁹

2003 - Survey by International Consultancy Group (ICG) of the UK, in collaboration with the Micro Industries Development Assistance and Services (MIDAS),

The ICG/MIDAS Survey showed that the total contribution of SMEs to GDP was to TK 741 billion in 2003. The survey broke down SME contribution by 11 sectors, among which the manufacturing sector had the highest contribution to GDP (38%) followed by agriculture (24%).

M.U Ahmed (2001) found that the small scale industries were distributed in the following manner.

¹⁸ BSCIC is required to maintain information and data bank on small and cottage industries in Bangladesh

¹⁹ However, the latest such survey by BSCIC was conducted in the late 1980s and it was based on the definition of small and cottage industries given in the earlier industrial policies (NOC 15)

Table 6: Growth of SSIs sector (Excluding Handlooms) in Bangladesh

Year	No. of Units		Employment		Value Added (TK.) Small and Cottage Combined
	Small	Cottage	Small	Cottage	
1981	24590	321743	322110	855200	17987
1991	38294	405476	523472	1331032	21154
2001 (end of June)	55916	511621	808959	166724	29323
Average Annual Growth Rate (% change)	6.36	2.95	7.55	4.73	3.15

Source: Ahmed, M.U., 2001.

The same author identified four sectors where SMEs were particularly present,

- Food and allied Products
- Textiles and Apparels
- Engineering
- Fabricated Metal products

The Bangladesh Bureau of Statistics yearbook, 1999, divided general industrial production into 8 types of broad based Industry groups. Textiles and Leather had the highest weight (37.419) % followed by Food and beverages, (23.295) % and Drugs, chemicals, (23.567%) (Mintoo, 2004).

A survey of 575 firms between 2004 and 2005, conducted by the World Bank gives wealth of information on production, industry and distribution by size of Bangladeshi firms in manufacturing in the last decade. This data set was used by the World Bank, 2007 development series paper “Strategy for Sustained Growth”. A summary is reported in Table 7.

Table 7: Firm Level Data, Size Distribution (% of Firms)

Industry	Number of Firms	Size Distribution (% of Firms)				
		Small (<10 workers)	Medium (10-50 workers)	Relatively Large (50-150 workers)	Very Large (150-500 workers)	Extremely Large (> 500 workers)
Pharmaceuticals	51		5.9%	15.7%	45.1%	33.3%
Food	88	1.1%	12.5%	44.3%	33.0%	9.1%
Garments	276		0.4%	0.7%	48.6%	50.4%
Leather/Footwear	24	4.2%	20.8%	33.3%	29.2%	12.5%
Textiles	136		2.2%	16.9%	44.1%	36.8%
Total	575	0.4%	4.0%	13.9%	44.0%	37.7%

The above table indicates that the size distribution varies significantly between industries; the garments sector had the highest number of firms. Food and leather footwear industry seems to employ a substantial number of people in the Small and medium enterprise category. Some sectors such as pharmaceuticals textiles and garments have invested heavily in large scale manufacturing.

However, as M.U.Ahmed (2006) suggests, the SME sector is undergoing a structural transformation with relatively new modern categories emerging, especially during the period of 1978-1991..The new categories include

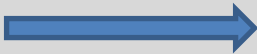
- Electrical goods and electronics
- Soaps and detergents
- Television and radio assembling
- Plastic Products and artificial jewellery
- Wooden and Steel furniture.

3.5.1 Industrial Policy and SMEs in Bangladesh

Hossain & Aladdin (2005) show that the Bangladesh Government took a slow and steady approach to market liberalization over the last few decades. This approach was reflected in the various versions of the industrial policies starting in 1982.

The overall approach of the industrial policy process was to promote more freedom and responsibility to the private sector to boost growth and development. The following table describes 3 types of industry categories and their reforms (Hossain & Aladdin, 2005)

Table 8: Industrial Sector Reform (ISR, 1991) (Hossain & Alauddin, 2005)

Reserved Category	Co- Current category	Free Category
Strategic Industries, mostly under Government Control e.g. include, Ammunitions, Atomic Energy, currency printing etc.,	Total 13 Industries :- Jointly controlled by both Public and Private	The rest of in the Industries.
	33 Public enterprises were converted to - Private Ownership.	

The Government of Bangladesh formulated a comprehensive Industrial Policy-2005 by putting special emphasis for developing Small and Medium Enterprises (SMEs) as a thrust sector for balanced and sustainable industrial development in the country to help deal with the challenges of free market economy and globalization. The Government identified 11 booster sectors, which is supposed to be reviewed every three years. The sectors are.

Electronics and Electrical

- Software Development
- Light Engineering
- Agro-processing and related business
- Leather and Leather goods
- Knitwear and Ready Made Garments
- Plastics and other synthetics
- Healthcare and Diagnostics
- Educational Services
- Pharmaceuticals/ Cosmetics/ Toiletries
- Fashion-rich personal effects, wear and consumption goods.

The latest Industrial Policy (2010) was primarily focused to accelerate the pace of industrialization for the Bangladesh economy (Bangladesh Economic Review, 2013). The primary focus of the policy is poverty alleviation and generation of productive employment through the empowerment of women in the industrialization process. (BER, 2013)

3.5.2 Emphasis on Light Engineering Sector

There was a special emphasis on the Light Engineering Sector because this comprises of mostly small size engineering enterprises acting in a supporting capacity for the various larger manufacturing concerns in Bangladesh (Ahmed & Bakht, 2010) & Rahman & Aslam & Sultana & Salam, 2013). The various industries include but are not limited to cement, paper, sugar and textile mills, plastic & railway and shipping and many more. The products can be broadly categorized as electrical, electromechanical and metal products converted to the form of repairing services, spare parts, casting, moulds and dies, and pipeline fittings (Ahmed & Bakht, 2010). Ahmed & Bakht (2010) estimates around 40000 firms are present in this sector, with about 1200 light engineering industries presently formally enlisted with Bangladesh Small & Cottage Industries Corporation (BSCIC).

“Dholaikhal, in the outskirts of Dhaka city which started as a collection of small traders, dealing with motor parts, and old motor vehicles, have expanded from 1971, to a small scale- motor Industrial zone today,. This is a place where anything from plastic to machineries, can be repaired and readjusted with a matter of hours. This is an ideal example of Bangladeshi SME contribution via clustering, where 30,000 to 40,000 owners and employees, are gaining experience every day through practical work, while working for their livelihood (Rahman & Aslam & Sultana & Salam, 2013).”

The light engineering sector is seen as a very important sector both domestically (industrial policy, 2005 & 2009) and internationally as per Export Policy, 2006-09, 2009-12 (Ahmed & Bakht, 2010). Rahman & Aslam & Sultana & Salam, in a 2013 study to understand the performance of selected light engineering product, identified factors such as lack of quality, steep pricing as export barriers that is preventing market control in foreign markets. Bangladesh Bank in its guidance document, “Small and Medium Enterprises (SME) Credit policies, & Programmes,” identified a total of 132 important sectors, where small and medium enterprises are actively present.

3.7 Does Bangladesh have a SME “missing middle phenomenon?”

3.7.1 Size and Composition of SME in Bangladesh

Table 7 (in pg. 34) on firm level provides the most relevant indicator on the size and magnitude of SMEs in Bangladesh. The table suggests that the small and medium category of firms comprises only a small share of the total number of firms. The small firm accounts for 0.4 % and medium category which includes (10-50 workers) include 4.0% workers. If the 2010 Industrial Policy definition is used, SMEs will include small, medium and relatively large firms in Table 7. However, even with the inclusion of the

latter, SMEs as a percentage of total number of firms is only 18.3%. There are sectorial variations with the SMEs in the Food industry and Leather industries accounting for a relatively larger proportion. As shown in chapter 1, in developed countries, the proportion of SMEs ranged from 95-99%. If this percentage is compared to that, of Bangladesh, we can reasonably conclude that there is indeed a “missing middle” in Bangladesh. The same conclusion is borne out by Tables 9 and 10 reporting data from the Bangladesh Census and the Bureau of Statistics.

Table-9 : Size and Composition of SME in Bangladesh – 1986

	Micro< 10	Small 10-49	Medium 50-99	SME 10-99	Large 100+	Total 10+	All
No. of Establishments (000s)	2117	47	2	49	2	51	2168
As % of all	97.62	2.16	0.11	2.77	0.11	2.38	100.00
Size of Employment(000s)	5316	779	164	943	949	1892	7208
As a % of all	73.75	10.80	2.27	13.07	13.17	26.25	100.00

Source : Bangladesh Census of Non-farm Economic Activities 1986, National Report, Bangladesh Bureau of Statistics, November 1989

Table 10 : Size and Composition of Manufacturing SME in Bangladesh 2001/03

	Micro< 10	Small 10-49	Medium 50-99	SME 10-99	Large 100+	Total 10+	All
No. of Establishments (000s)	440	26	2	28	4	32	472
As % of all	93.2	5.5	0.5	6.0	0.8	6.8	100.00
Size of Employment (000s)	1506	488	156	644	1580	2224	3730
As a % of all	40.4	13.1	4.2	17.3	42.3	59.6	100.00

Source : Economic Census 2001 & 2003, National Report (Preliminary), Bangladesh Bureau of Statistics, July 2005

Table 11 compares the contribution of SMEs to GDP in various groups of countries. It shows that the contribution in Bangladesh (while larger compared to that of Pakistan) is relatively small compared to the emerging and the developed economies.

Table: 11: Contribution of SMEs to GDP (%) Source Bahar & Uddin 2007

	<i>Developing Nations</i>	<i>Developed Nations</i>	<i>Emerging Nations</i>
Country	Bangladesh 20-25	Japan 69.5	Brazil 60.8
	Pakistan 15	USA 52	China 60
		Canada 43	India 80.0
		UK 52	

Cited from Bangladesh Bank Policy Paper, 2008

3.7. 2 Comparison of SMEs in India/ West Bengal with SMEs in Bangladesh

Micro, Small and Medium Enterprises (MSMEs), have long been a fundamental part of businesses in India (Jahanshahi, Nawaser & Khaksar & Kamalian, 2011). However similar to the problem faced by Bangladesh, the MSMEs have not been well defined in India (Das & Shil & Pramanik, 2007).

The 2009-2010 annual report of Ministry of Micro, Small and Medium Enterprises, of India, shows a breakdown by size of firms which suggests that there could be a SME missing middle, in terms of number of employment. The overall combinations of the total number of small and medium enterprises are less than 40% (Table 11 a)

Table 11 a : Contribution of Indian SMEs to Employment by Sectors,

Type	Number of Employment generation by MSME
Micro	6360840. (69%)
Small	2209485 (24%)
Medium	633339 (7%)

Source: Annual Reports, Ministry of Micro, Small and Medium Enterprises, Government of India (2009-10) Cited from (Jahanshahi, Nawaser & Khaksar & Kamalian, 2011)

MSMEs in India are broadly classified into two categories, - manufacturing and those engaged in providing services. Among the Indian MSMEs, those in West Bengal figured prominently (second out of 10 states cited in The Indian MSME Annual Report 2012-2013) in terms of number of enterprises (44.03 lakh) and employment (85.78 lakh).

However, as Table 11 indicates, there is a huge gap between Bangladesh and India in terms of the contributions of the SMEs to GDP. Unlike Bangladesh, a massive proportion (no of enterprises) of SMEs in India are involved in the manufacturing sector (67% of total) (Jahanshahi, Nawaser & Khaksar & Kamalian, 2011). In terms of employment by sectors, Indian SME in manufacturing employs a very large proportion (7984321 people comprising 87% of individuals), while services comprise of (1219343 people comprising 13% only) (Jahanshahi, Nawaser & Khaksar & Kamalian, 2011).

The state of West Bengal of India shares similar cultural and linguistic heritage with Bangladesh. Similar to Bangladesh, the state has gone through various phases of economic problems, poverty and de-industrialization (Sen, 2009). Primarily an agriculture dependent state, West Bengal occupies only 2.7 per cent of India's land area, but supports over 7.8 per cent of the population (Sen, 2009). Early industries like the coal mining industry (est. as early as 1820) and engineering industry (for the creation of river transport and railways) were results of the effects of British colonization (Sen, 2009). Availability of Jute as a traditional local cultivation established itself as an industry making hand-woven cloth and many more, the iron and steel industry & tea gardens also emerged under the British Rule. These four industries—coal; engineering, iron and steel, & Jute referred to as traditional industries—dominated Bengal's economy for many years (Sen, 2009). Coir Industry is an agro-based traditional industry and India is the largest coir producer in the world accounting for more than 80 per cent of the total world production of coir fibre. While originating in the state of Kerala, West Bengal, a coconut producing state, joined the bandwagon, with other states like Tamil Nadu, etc. (MSME, Report, 2012-2013)

In contrast, the SMEs in Bangladesh have evolved beyond the traditional sectors to venture into more modern non-agricultural sectors like light engineering, knitwear and garments, leather and health diagnostics. These movements have shifted the focus of the Bangladeshi SMEs beyond a proto-industrialization process and reduced its reliance on agriculture.

In terms of problems & constraints of SMEs in India, Lahiri (2012), highlights that while financing has always been a major problem for the SMEs in India, competition especially from multinationals and large domestic firms pose as greater constraints. Issues with power supply, transportation and lack of water supply also pose as growth constraints (Lahiri, 2012)

3.7.3 Additional Evidence of a “Missing Middle”

(Minto, 2006) followed up on the Ministry of Industries led BSCIC (Bangladesh Small and Cottage Industries Corporation) survey in 1978 to find the actual number of SMEs that exist in Bangladesh. However the survey's dependability was questioned and was never updated in the following until 2003, when a number of local and international organization jointly conducted The National Private Sector

Survey of Enterprises. This survey found that the wholesale & retail trade comprised 40% and for the manufacturing SMEs comprised only 14 percent.

Alam & Ullah, (2006) point to an increasing growth of SMEs in the non-manufacturing sector, but found that in the manufacturing sector the number of small enterprises (26000) far outweigh the number of medium enterprises (2311). According to the Economic Census (2001 and 2003) (BBS), the number of medium enterprises stood at 6 % of the total number of enterprises (5,125) (BB Policy Paper, 2008). (Zaman & Islam 2011) in their study to explore the employment distribution between micro, SME and large enterprises highlighted major evidence from the Bangladesh Economic Census survey of 2001 & 2003. They reported that the medium and large units only comprised of a total of 12% (5.7+6.9) of total industrial units and small and medium enterprises, accounted for 35 percent and 8.8 percent of employment respectively. They highlight important evidence showing both small and medium enterprises are more involved in Trade and services (64.5%) than manufacturing (35.5%). However their definitions of SMEs were not strictly consistent with the Industrial Policy 2010 definition.

Beck & Kurt (2006) found that SMEs employ more than 50% of total employment in manufacturing in many developed countries. In a similar type of research Ayyagar et al, 2007, emphasises the contribution of SMEs to be 60 % of total formal employment in the manufacturing sector globally, and focusing on the size and structure of manufacturing SMEs in Bangladesh (Zaman & Islam 2011) find that manufacturing SMEs provide only 29% of the manufacturing employment and comprise of 8.8 % of manufacturing establishments for the country.

Chowdhury & Azad & Islam, in their 2013 study on SME financing in Bangladesh share similar insights that SMEs in Bangladesh, contribute 30 % of Bangladeshi, Industrial GDP but contribute 82 % of the industrial sector employment. They show evidence that mostly the big and medium scale industries are involved in the individual structure, of textiles, paper, steel, cement, chemical, fertilizer, engineering, and pharmaceutical industries. Findings from the same study, showed clearly weak relationships between the SMEs and large enterprises. 20% of SMEs are involved in the Industrial market, where, 40 % is involved in the retail trade (Table 7.4, pg. 4).

Rabbani & Sulaiman (2005) puts greater emphasis on the potential of manufacturing SME, in employment creation. They however acknowledge that trading (and other services) is the dominating activity for SMEs in Bangladesh and that government policy; financial constraints, etc. act as key barriers for SMEs to not enter the manufacturing market. Additionally textiles, and other non – metallic mineral such as clay and brick products, food, plastic, and furniture products, were found to be the major booster SME categories. (Alam & Ullah, 2006) (Zaman & Islam 2011) also identifies a few individual sub sectors

such as textiles, light engineering, and food sectors, as traditionally dominant for the economy of Bangladesh.

All this evidence suggests an uneven structure of the manufacturing structure for Bangladesh, The concentration of the manufacturing sector in the two extremes (small & large industries are not only present in terms of employment, but a similar pattern can also be observed for no of enterprises and GDP contribution).

This clearly constitutes a “missing middle” problem, particularly for the manufacturing sector. Similar conclusion was reached by the 2008 Bangladesh Bank Policy Paper. This report further stressed on the “gap” of the lack of ability of small firms to move upwards and transform into medium size firms along with preserving their employment generating potential to absorb the growing labour force in Bangladesh.²⁰

²⁰It is important to highpoint that this “missing middle” position is situated based on available statistics, which is not comparable to the latest statistics, or lack of it because of a change in the criteria of the definition and lack of comprehensive level data at the national level. (SME Finance Monitor, 2013). Further analysis of the impact of the financial gap on the missing middle will be evaluated in the next chapter.

Chapter 4: Factors causing the Missing Middle in Bangladesh

4.1 Surveys of Financial and Non- Financial Constraints for SMEs in Bangladesh:

Table 12 below, provides conclusions from 13 surveys about constraints for SME growth in Bangladesh. A distinction is made between financial & non- financial constraints to separate the impact of the financial constraints.

#	Source & Survey Year	Area	Broad Industry Categories ²¹	Sample (SMEs/ Firms)	Respondents	Findings : Is Financial Constraint a major Barrier to SMEs	Major Non- Financial Constraints
1	(Ali & Mian & Islam in 2009) Year : 2009	4 major Districts of Bangladesh(Representing a large SME number	Food & Allied products. Textiles and Apparels Engineering Fabricated Metal products.	300 SMEs	95	NO, Resources and Finance has no significant effect on Business Success in Bangladesh.	Lack of : Management know-how Products & Services Cooperation
2	(Amin & Banerjee, 2007) Year : 2006	(India & Bangladesh	Manufacturing IT, Export Processing Retail Repair Medical/Clinical Others	133 for India & 112 for Bangladesh)	N/A	NO: Availability of credit / loan & positive cash flow a major issue. For Bangladesh. (The paper concludes that credit & financing is not a major issue for Bangladesh.	Price War Finding Qualified Employees Domestic Competition
3	(Chowdhury & Ahmed, 2011) Year : 2011	Bangladesh (3 districts, Dhaka, Munshigonj & Barisal Districts	Electronics & electrical product Software making Plantation agriculture	54 SME entrepreneurs & 8 Banks	N/A	Yes, Non Availability of Finance, as 47% responded, loan granting procedures are very complex.	Lack of Electric Supply Inadequate Infrastructure Lack of Skilled Worker
4	From the study (Sarder Jahangir, 2001) ²² Year : 2001	Bangladesh	Various	19	19	Yes: high rate of interest on bank loans as a key constraint.	lack of modern technology lack of adequate investments Irregular/inadequate supply of power

²¹ If available

²² Obtained from (Ahmed, M.U, 2006)

5	M.M Rashid, 2012 Year 2012	Literature Review of Various barriers of SMEs in Bangladesh	N/A		N/A	Lack of credit/finance/capital is the 4th major problem among a total list of 14.	Lack of Market Intelligence Innovation in Management Technological Networks
6	Bangladesh Bank, June 2008 Year : 2007	Bangladesh, Historical Data Comparison, (1992-2007)	large vs Small scale industry in Bangladesh		N/A	Yes : Massive gap in the share of lending and working capital -large vs Small scale industry	N/A
7	Tambunan, 2000) from the study Tambunan, Tulus T.H. (2008c), Year : 2008	Multi Country Study, Asian Countries	N/A	13	13	Yes, Lack of Capital is one of the 4 major constraints for Bangladesh.	Tech & Skill Market Environment Energy
8	(Weiser & Wiebe, 2003) Year : 2003	Single District assessment Mymensingh, Bangladesh	Service (89.4 %) Manufacturing (10.6%) Major enterprises -Retail grocery Pharmaceutical and medical goods -Textiles, clothing and leather	430 Firms	N/A	Mixed Information- 95% used personal savings 60% said yes to limited access to credit, because of high collateral mainly fixed assets.	Regulatory Burden Law & Order Physical Infrastructure
9	Chowdhury & Azam & Islam, 2013 Year : 2013	Bangladesh	Trade & Traders Agro Processing Products Import & Export Sea Services Company Steel Furniture Etc.	100	N.A	Yes: Various obstacles faced by SMEs in getting Loans, Additionally Lengthy process & too much paper work creates further constraints.	N/A as specially financial Access Survey
10	Schiffer & Weder, 2001, (Worldwide Survey) Year : 2001	The South Asian Sample made up of 3 countries. Bangladesh, India & Pakistan	Not mentioned	10,090 firms	N/A	Financing is the second most important constraint,	Political Instability Financing Corruption Table 3.4)

11	The ICGT/MIDAS Survey Cited in (Mintoo,A.A , 2004) Year 2003	Nationwide Survey of Private Sector in Bangladesh	N/A	10096, Enterprises	N/A	Yes Three most urgent issues:- Priority 1: Finance	Priority 2: Power supply Priority 3: Road Conditions
12	The World Bank , IFC, Doing Business Report 2014 Year : 2013	Bangladesh	N/A	10,200 local experts contacted	N/A	Not a Priority	Getting Electricity Registering Property Enforcing Contracts Trading Across Borders
13	The World Bank Enterprise Surveys Year 2013	Bangladesh	Food Garments Leather Products Chemical and Chemical Products And more	1442 firms	N/A	Access to Finance	Political Instability Electricity Corruption

The 13 surveys are specific to the SME business environment of Bangladesh. They provide a wealth of information about the various constraints faced by SMEs in Bangladesh. However it is important to point out that the surveys follow different methodology and is therefore often not comparable. The conclusions drawn below are based on consistent data whenever possible.

Jahangir Sarder (2001), identified from a small survey of 19 Small and medium entrepreneurs in Bangladesh that a high rate of interest on bank loans was a key SME financial barrier. Schiffer & Weder (2001) studied on a South Asian sample of firms from Bangladesh, India and Pakistan, and highlighted that financing is a major constraint but the political instability during that time, was causing more disruption for SME prosperity. Amin & Banerjee in (2006) compared 133 Indians and 112 Bangladeshi SMEs in various sectors, to come to the conclusion that credit & financing is not a major issue for Bangladesh. It was an interesting finding, that Bangladeshi small and medium enterprise entrepreneurs as opposed to Indian SMEs are able to diffuse their financial pressure by taking financial help from family and informal networks. Amin & Mian & Islam (2009), established from investigating 300 SMEs in 4 major districts in Bangladesh that lack of management know-how and services cooperation had more impact than finance. These findings highlight that non-financial constraints are an equally important areas that needs further examination.²³ The ICG/MIDAS Survey which is a breakthrough survey for Bangladesh as cited in Mintoo, (2004), closely inspected and carefully interpreted a large sample of

²³Also I question the selectivity criteria of the industry categories and some sectors in India for example IT may not have the same representative characteristics in Bangladesh

10096 enterprises, to re-establish that lack of financing is a major issue for SMEs in Bangladesh at least during the 1990s

The import substitution policies of the Government of Bangladesh, during the 1960s-1980s, gave a lot of industries protection against tariff barriers. The agriculture and agro-tools industry were among many to get that support from the government (BEI, Agro Tools, 2004). Unfortunately the industrial policies initiated between 1970 and 2000 did not focus on SME development (SME Finance Monitor, 2013). However, the private businesses faced various regulatory barriers including those on credit disbursement, investment sanctioning, import licencing and many more. These affected their flexibility and profit maximization.

Tulus Tambunan's (2008) survey of SMEs in Asian Developing Countries, including Bangladesh, further suggests that regulatory barriers adversely affected all stakeholders of the private sector, especially the SMEs. However the SMEs had limited capacity and capability to deal with the situation compared with their larger counterparts (Tambunan, 2008). This indicates that while access to financing was a major constraint, it was even more so for the SMEs because of their lack of capacity to deal with the complex regulations. This combined with their informal nature created a situation that SMEs could not even tap into the funding programs that were specifically made available to them (Tambunan, 2008).

Most surveys highlight the issue lack of access to finance as a major issue. The Government has responded by establishing targeted lending projects (Tambunan, 2008). Other barriers, like access to electricity, lack of skilled workers & corruption were seen as major bottlenecks to general industrial growth for Bangladesh (including both large enterprises and SMEs). The World Bank, "Doing Business" project, which provides objective measures of business regulations for local firms in 189 countries, emphasizes the issue of electricity as a prime concern for Bangladeshi businesses in their latest 2013 update. The World Bank 2013 Bangladesh chapter of Enterprise Surveys, adds further that corruption and political instability was a major obstacle for Small and medium enterprises.

The 13 surveys presented above are based on a very large sample of Bangladeshi firms and can be considered to represent an appropriate sample to reflect and understand the constraints faced by small and medium enterprises of Bangladesh.

This major constraints identified by these surveys are:

- ✓ Lack/Access to Finance: This includes lack of finance/credit/capital. 10 out of 13 Surveys explicitly highlight financing as a major issue.²⁴
- ✓ Inadequate Infrastructure (particularly energy) comes out as the second most crucial constraint. 7 out of 13 Surveys, mention that energy/electricity is one big barrier for SME business success²⁵

Other identified barriers include, lack of skilled workforce & lack of technology (access & innovation)

While corruption and political instability are notable mentions, the SMEs in Bangladesh do not seem to consider these issues as major constraints for growth.

4.3 Infrastructural Issues

The World Economic Forum's Annual Global Competitiveness Index 2012-2013, indicates that inadequate supply of infrastructure is one of the most problematic factors for doing business. World Bank's Doing Business Report 2014 ranks Bangladesh 189 (the lowest rank among entire South Asian sample) for the ease of getting electricity, indicating terrible performance in the area of power generation, supply reliability and ease of access. Issues related to power supply is considered to be one the most significant binding constraint to growth of firms, and business, and citizens. This is the same for Bangladesh where an energy crisis has been present for many years (Bangladesh Poverty Reduction Strategy Paper, 2013). There has been power shortage affecting all kinds of business operations and demand has been outpacing the power generation.²⁶ The energy shortfalls are due to inadequate supplies of natural gas, the principal fuel, and inadequate maintenance of facilities²⁷. The report also highlights that Bangladesh had made getting electricity more difficult by imposing a moratorium on new connections which has caused delays for businesses and customers all alike in 2012.

²⁴ Survey numbers for Financing (3,4,5,6,7,8,9,10,11,13)

²⁵ Survey numbers for Infrastructure (3,4,7,8,11,12,13)

²⁶ Private Sector Investment in the Power Sector, Manzur Ahmed, Pg 11

²⁷ World Bank Development Indicators, 2013

4.4 Is there a lack of financing Problem?

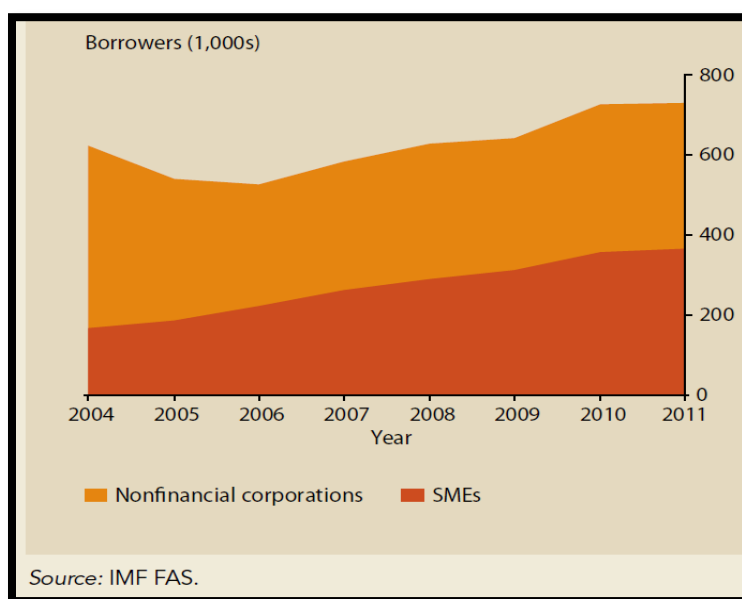


Figure 6: SME Borrowers of Commercial Banks in Bangladesh (Source: IMF FAS 2012)

Figure 6 illustrates the access to financing issue for the SMEs.(IMF Financial Access Survey (FAS) 2012). The SME borrowing from a commercial sources show a progressive upward trend over the period of 7 years (2004-2011) of the survey. The data indicates that SME finance in Bangladesh has increased significantly over time with the share of commercial loans of SME borrowers increasing to 50 % in 2011 from 27% in 2004 (IFC FAS, 2012)

The annual Asia Finance Monitor, 2013 provided sectoral details of SME borrowings in Bangladesh. Its Bangladesh country review highlights the fact that while bank lending to SMEs has shown a progressive increase in 2012 of 31.1% from the previous year, overall, the SME commercial lending is very narrow in scale, covering only 6.7% of GDP. This includes both banking and nonbanking lending.

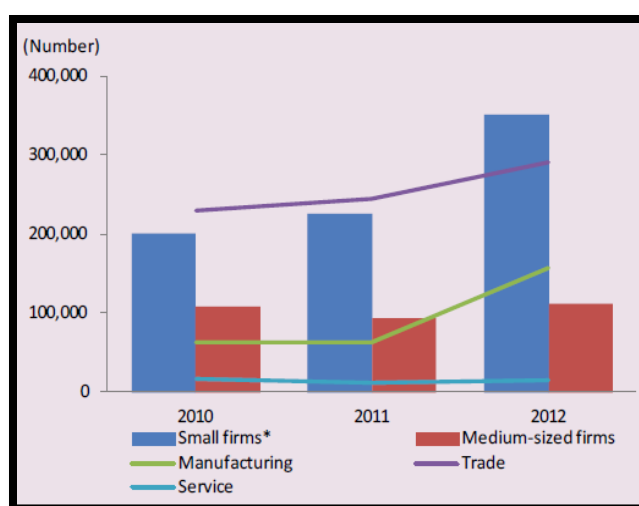
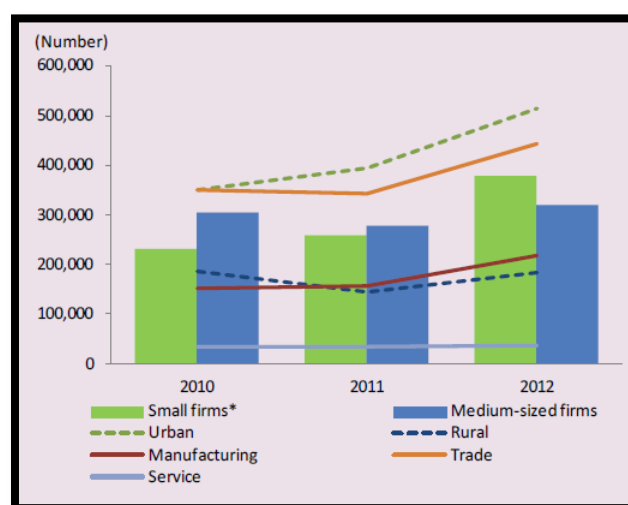
Figure 7: SME Borrowers²⁸

Figure 8: SME Loans by Size & Sector



According to figure 8, the manufacturing sector was the second most active sector in SME lending, after the wholesale and trade sector with a 38.5% increase in 2012 over 2011. By firm size, loans to small enterprises which include the cottage industries, had a sharp increase of 7.9 % in 2012, and amounted to 54.2% of total SME commercial loans. The number of SME borrowers in the manufacturing sector has seen a close to double rise from 63,458 in 2010 to 111,824 in 2012. The medium sized firms, had a slight slump in the number of borrowers, after 2010, but picked up again in 2012. (SME Finance Monitor,

²⁸ For both Figure 1 & 2, SME (includes cottage enterprises) & Source , Bangladesh Bank data, cited from ADB Finance Monitor Report, 2013

2013). These improved statistics for SME financing indicate that financing as a factor for causing the 'missing middle' problem may be reducing over time..

However, such a conclusion needs to be cautiously approached because of the inconsistencies in definitions of SME over time that make it difficult to create a comparable time series.

Dr. Momtazuddin Ahmed in his newspaper article in 2013 cautions that by international comparisons, the new unified definition set by IP 2010, already revised upwards (in terms of employment and assets) three times within the past 10 years, could lead to a "mis-targetting" of the intended beneficiaries in the small scale sector. All Banks and nonbank financial institutions (NBFIs) are given an annual credit volume target by the Bangladesh Bank (Central Bank) to be released to SMEs (SME Finance Monitor, 2013). Part of the increased commercial lending to the SMEs during 2009 -2012, evident in Figure 8 could in fact have been to 'corporate borrowers in disguise' taking advantage of the increased number of employees and assets allowed under the new definitions,

While the number of SME borrowers and SME loans disbursed has increased over the years, financial institutions complain that, poor collateral, inadequate business plans and documents from SME owners, create challenges for loan disbursements. On the other hand, SME owners claim that strict collateral, guarantee requirements and high interest rates, continue to create barriers for SMEs to access finance. In addition minimum paid-up capital requirements have prevented many SMEs to enter the formal capital markets. At present there are no specialized capital markets for SMEs in Bangladesh.

Given the informal nature of SME behaviour, the Non-Banking Financial Institutions (NBFIs) have realized that SME financing is a crucial business area, and they are trying to expand their services in the form of a wide –ranging financing models, from loans, leasing, factoring, syndicate financing, securitization, distributor financing and many more (SME Finance Monitor, 2013). There are at present 31 Non-Banking Financial Institutions operating in Bangladesh, which include 15 joint venture firms, 13 private commercial firms, 2 state owned firms, and one single subsidiary firm of a state owned bank (SME Finance Monitor, 2013). The annual report published by ADB investigates, that non- bank financing sector in Bangladesh has decreased in 2012 from 2011, and is quite small in scale for Bangladesh. However, the largest NBF in Bangladesh, (The Industrial Development Leasing Company of Bangladesh) has seen a 50% increase in the no. of clients from the year 2011.

4.5 Other issues - Evolution of the Industrial Structure

Large enterprises have an important contribution to make for the growth of SMEs and vice versa through the process of forward and backward linkages (Ahmed & Rahman, 2012). (Berry (1997) explains for large firms it is efficient to sub-contract some inputs or components to smaller firms. These subcontracting processes by large enterprises eventually create clusters of “small firms” where they cooperate and interact in mutually productive ways (Berry, 1997). Ahmed & Rahman (2012) highlights that the success of co-production partnership have had eventually led to the industrialization of countries like Japan and Korea. Subcontracting has also led to the flourishing of SMEs and small rural entrepreneurs in Japan (Tamangan et al 2004, cited in Ahmed & Rahman, 2012).

The question is whether sub-contracting arrangements exists in Bangladesh and if so whether they contribute to the growth of the SMEs.

As of 2009 the Ready Made Garments (RMG) sector (with close to 4000 businesses) was the largest foreign exchange earner, accounting for about 79% of the total export earnings and 12% of GDP (Ahmed & Rahman, 2012). Apu (2013) explains that subcontracting firms are very much evident in the textile and clothing sector. The subcontracting chain is complicated and part of the informal sector. Due to the many complex tasks performed by the principal large enterprises, different types of sub-contracting take place (Apu, 2013).

For example Apu,(2013) states “A large knit apparel manufacturing enterprise may maintain two facilities namely- garmenting and knitting while dyeing of fabrics is contracted out to intermediate subcontractor, who are much smaller business units, Even yarn manufacturing (the raw material for knitting) is contracted out to ‘backward subcontractor’. The finished apparels is forwarded to buyer to sell out is ‘forward subcontracting’.

There are about 5050 apparel manufacturing industries in Bangladesh. There are also, 721 fabric manufacturing mills, 233 dyeing industries and 385 yarn manufacturing mills (Apu, 2013). Therefore (RMG) sector plays a crucial role in not only the manufacturing sector, but also, for employment generation for many smaller enterprises, who are often the sub-contracting partners ((Ahmed & Rahman, 2012).

Chapter 5: Conclusions and Recommendations

The analysis in this paper suggests that there is indeed a “missing middle” issue for the SMEs in Bangladesh based on their contribution to GDP and employment relative to similar contributions by the SMEs in the emerging and the developed economies.

The major causes for the missing middle are infrastructural problems particularly access to power and a continuing lack of access to financing although the latter situation shows signs of improvement. Other issues relate to the still nascent links between the large enterprises and the SMEs in a value chain process except in the case of the RMG sector. These issues are quite different from proto-industrialization based SME development as in West Bengal. The SMEs in Bangladesh have diversified significantly overtime venturing into industrial sectors unrelated to the agricultural sector.

*Lack of Financing*²⁹

The Bangladesh Bank has implemented several financial programs and arrangements to support SME Enterprises. A specialized department within Bangladesh Bank called “SME and Special Programs Department” has been created to be responsible for policy formulation, monitoring and development, and facilitating fund activities of SME sector.

The facilities include opening of ‘Dedicated Desk’ for SME and ‘SME Service Centre’ in the commercial banks and special facilities for the women entrepreneurs. Despite facing various hurdles (cultural, institutional and even bureaucratic), women entrepreneurs have seen greater participation and involvement in the SME sector, especially in agriculture, RMGs, furniture, handicrafts, and the poultry sector. The Government introduced Refinance scheme funded by Bangladesh Bank, IDA and ADB to encourage the banks and financial institutions to provide credit to the SMEs. The ADB as part of its country assistance strategy set up SME Foundation, to support the Government. While BRAC bank and BASIC Bank, were selected by Bangladesh Bank as lead banks responsible for the distribution of the credit and venture capital fund.

Other notable contributions include financing 212 projects from Tk. 100 million dedicated to Equity Development Fund in the revised budget of FY 2005-06, and allocation of TK. 100 million, under the Agro-based Industries Assistance Program, to credit support agro- based farm and industries.

²⁹ See Further in Alam & Ullah, 2006 & SME Credit Policies & Program, Bangladesh Bank
Azfar Khan Course – DVM 6998: Supervisor: Philippe Regnier SIDGS, University of Ottawa

5.1 Recommended actions

Although the supply of institutional finance is improving, it still remains inadequate for the SMEs. This gap can be filled through the establishment of or further enhancement of development finance institutions.

However, the Government alone cannot and should not provide adequate finance for transformation, expansion and technical advancement of SMEs. The credit line needs to be made available by private financial institution and more importantly non- banking institutions such as NGOs³⁰

One important lesson from SME financial institutions from India is that for the SMEs, it is essential conditions are created to ensure their survival especially in the initial years. It is because in the long run, the surviving SMEs become profitable business opportunities for the financial institutions. Adequate financial support especially during start up is necessary for the healthy development of this sector and for the development of the client base for the banks.³¹

In addition to considering collateral free or partial collateral loans for SMEs, Banks and NBFIs need to evolve and expand other innovative financial product lines for SMEs to meet the diverse demands of SMEs, such as raising funds through syndication and domestic factoring which have emerged as successful tools of SME financing in many countries.³²

In terms of access to credit and availability of capital financing, it could be fruitful to reduce collateral requirements, educational qualifications and technical conditions for obtaining loans so that enterprise growth potential could be the only basis for financing SMEs. A dialogue between the various stakeholders including governmental partners such as Ministry of Finance, Ministry of Industries, Ministry of Commerce, Bangladesh Bank, should be organized to ensure the provision of seamless, effective and affordable financial service to the SMEs.

³⁰ See more in Uz Zaman & Islam , (2011)

³¹ See more at Shrimohan Yadav's article on "Innovative ways in Financing SMEs : Experiences from Thailand and Vietnam", 2008

³² Bangladesh, (PAU Report, 2008)

Infrastructure:-

The research in this paper suggests that physical infrastructure³³ needed for the development of SMEs is weak in Bangladesh. However, infrastructural issues are national in scope and will be needed to be addressed at that level. The government of Bangladesh needs to adopt an appropriate strategy for addressing the infrastructural bottlenecks, especially power, gas, and transport that are significant deterrents to SME expansion. A long term investment plan is required to improve the present situation by eventually establishing common commercial power plants or separate power plants – for specific industry clusters. This will ensure that the industry has facilities to get priority power connection and gas supply especially energy supply for at least eight to twelve hours a day. In the short run, addition of SMEs in export processing zones (EPZs) or setting up exclusive SME industrial parks may mitigate some of the problems of weak infrastructure.³⁴

Value chains – Sub- Contracting

The research also indicates that in the RMG sector; the SMEs overcame size constraints and market competition by using business networks and industry clusters. This collaborative action between large firms and SMEs needs to expand to other sectors. The Government, through its industrial strategies needs to facilitate arrangements on multi-layered subcontracting arrangements between the large enterprises and the SMEs and among the SMEs themselves. The greatest scope for improvement is in the establishment of forward and backward linkages within the industrial structure in Bangladesh. Forward linkages can be developed through improved services, packaging, and processing, storage, and transport, removal of marketing constraints and opening up of new markets. Backward linkages will be particularly important in agro-based industries through the provision of inputs (seeds, fertilizers, animal feed and agriculture machinery). The provision of post-harvest storage facilities and improvements in processing and packaging of farm products such as fruits and vegetables will also help.

³³ (e.g., roads, gas and electricity),

³⁴ See more in (Razzaque, 2003) & BB PAU Paper, 2008

Other Innovative Solutions

The adoption of e-finance by Bangladeshi SMEs has been slow compared to the larger companies in Bangladesh or SMEs in other developed countries (Claessens et al. 2002; Tsai et al. 2006). The Bangladesh government, financial and IT support institutions, even donor agencies and resource centres should collaborate to work together to adopt e-finance mechanisms ranging from internet, online payment processes or a “Mobile Message Awareness Service” for the SMEs to enhance the growth potential of the SMEs.³⁵

A help desk with computer and internet facilities potentially set up in bank branches dealing with SME finance, trade promotional bodies, and in all chambers of commerce and industry and other trade promotional bodies could also extend the outreach to the SMEs.³⁶

To ensure the quality of the SME products, the Government could establish a credible certification authority especially for the SMEs, so that this sector can obtain a technical evaluation of the quality of their products within a short time. This standardization process should be internationally authenticated and accepted.³⁷

³⁵ See details in (Riyadh & Bunker & Rabhi, 2010)

³⁶ Uz Zaman & Islam, 2011

³⁷ Chowdhury & Ahmed, 2011

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