

Report On

“An observation of SME foundation promoting capital market to SMEs in Bangladesh as an alternative source of financing through QUALIFIED INVESTOR OFFER (QIO).”

By

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An internship report submitted to the BRAC Business School in partial fulfillment of the requirements for the degree of Bachelor of Business Administration

BRAC Business School
Brac University
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Declaration

It is hereby declared that

1. The internship report submitted is my original work while completing my degree at Brac University.
2. The report does not contain material previously published or written by a third party, except where this is appropriately cited through full and accurate referencing.
3. The report does not contain material that has been accepted or submitted, for any other degree or diploma at a university or other institution.
4. I/We have acknowledged all main sources of help.

Student's Full Name & Signature:

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Letter of Transmittal

Md. Shezanur Rahman
Lecturer,
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Subject: Submission of internship report.

Sir,

For your consideration, I am submitting my internship report titled “an observation of SMEF Foundation promoting share market SMEs in Bangladesh as an alternative source of financing through QUALIFIED INVESTOR OFFER (QIO).”. The report has been written in the instructed format provided by BRAC BUSINESS SCHOOL.

For the completion of my partial credits on internship, I joined SME FOUNDATION where I worked and observed/studied particular areas of its operations to Facilitate SMEs. Here, I was introduced to the office setting and had the opportunity to learn new skills. I have put a great deal of effort into preparing this internship report and did some review and research in the process. findings in this report for submission. I have laid out my findings in this report as best as I could.

Sincerely yours,



RAFA SAADMAN

18104123

BRAC Business School

BRAC University

10th June, 2022

Non-Disclosure Agreement

This agreement is made and entered into by and between SME Foundation and the undersigned student at BRAC UniversityRAFA SAADMAN.....

Executive Summary

Small and Medium Enterprises in Bangladesh are major contributors to the country's economy with all the signs and potentiality of humungous growth in the next few decades. However, sources of financing at affordable cost and proper accommodation had always been a barrier in the way to their optimal growth. During my period of internship at the SME Foundation, I have observed SME Foundation's "Credit and Finance Services" wing in promoting the capital market to SMEs throughout the country and growing interested in the reasons for yet an underdeveloped capital market participation of the SMEs.

This Report generates insights on the way SME entrepreneurs perceive bank loan availability, their perception of the advantages and drawbacks of QIO offered by SME Foundation and BSEC as well as the current Scenario of SMEs which issued shares via QIO. The report also sheds some light on the banking industry and its inclination toward SME financing.

Keywords: SME financing; QIO; Capital; Loan

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List of Acronyms

QIO	Qualified Investor Offer
F&CS	Finance & Credit Services wing
ToT	Training of Trainers
SCP	Secondary Capital Platform
SMEF	Small and Medium Enterprises Foundation
MoU	Memorandum of Understanding
AGM	Annual general Meeting

Chapter 1: Overview of Internship

1.1. Student Information

Name: Rafa Saadman

ID: 18104123

Program: Bachelor of Business Administration (BBA)

1st Major/Specialization: Finance

2nd Major/Specialization: Human Resource Management (HRM)

1.2. Internship Information

1.2.1 Period, Company Name, Department/Division, Address

For the completion of my BBA program, I joined as an intern at “Small and Medium Enterprises foundation (SME Foundation)” Bangladesh for a Three-month term from 1st February, 22 to 30th April, 22 in the Finance & Credit Services wing (F&CS). It is situated in E-5, C/1West Agargaon, Sher-e-Bangla Nagar Administrative Area, Dhaka 1207.

1.2.2. Internship Company Supervisor’s Information

I worked under the direct supervision of Md. Nazim Hassan Satter, the general manager of the wings related to Finance and Credit wholesaling, Business Support Services, Development Projects, and Institutional Linkage at SME Foundation. He had been a part of the organization through the Lien agreement since its inauguration in 2007 and had previously worked at Bangladesh Bank (BB).

1.2.3. Job Scope – Job Description/Duties/Responsibilities

Despite initially being assigned under the Finance and credits wholesaling wing, I was transferred to different wings usually every 2-weeks. Following are a few of the responsibilities that I was accountable for during my work at the SME Foundation.

- Answering online questions on the SMEF website submitted by prospective fund Seeking SME owners regarding policies and upcoming events. I also had to maintain mail correspondence with these businessmen. This included collecting vat/tax/tariff/cash incentive proposals from SME business owners.

- Receiving and cross-checking invoices from different wings of the organization for the finance wing's approval and maintaining a spreadsheet for these expenses as well as keeping a tab in written form.
- Promotion of the Covid-19 stimulus package to SME owners online and in-person while attending seminars.
- Attending seminars often where SME business owners are invited to convince them to join the capital market as an efficient way of funding through collective discussions and listening to their concerns.

1.3. Internship Outcomes:

1.3.1. Benefits of being an intern at SMEF

The major benefit of working at the SME foundation was to have valuable knowledge and insights while working under former employees in BB and Chittagong and Dhaka Stock Exchanges. On the other hand, the strict culture of the office required me to show utmost discipline in showing up every day at work and facilitating the learning by dealing with Various SME business owners, attending seminars and workshops, etc.

Moreover, the occasional field trip to different SMEs helped me to understand the financing strategies and drawbacks of different SME organizations in Dhaka. Furthermore, having integrated into the office environment has given me the expected confidence to show professionalism and make a meaningful link with co-workers for interpersonal skills development.

1.3.2. Problems/Difficulties

- Since I was the first intern-student at SMEF, there was initially no written set of Job responsibilities. During this time, there were a lot of preparations in the office that created some confusion for the first few weeks.
- Due to the annual general meeting and the preparations leading up to it, my supervisor was busy for 2 weeks. Hence, it was a bit hard for me to find crucial material/documents for making this report during that time.
- Despite being a Finance major, I had limited knowledge about the SMEs in our country, their financing traditions, and relevant policies. Consequently, this was a huge roadblock in formulating a more effective topic for the completion of this paper.

1.3.3. Recommendations For Future Interns

I would advise future interns to know that SMEF is not a business organization and rather a government agency acting as a facilitator for Financing SMEs. For this reason, their reporting format may not include analyses exactly like the BRAC's report format. An intern should be prepared while choosing their topic.

Also, Attending the seminars and field trip is advisable for a SMEF intern because this will help to grow interested in different SME-related topics and may also help in choosing a niche topic. Lastly, I think SMEF should create a very specific set of written job descriptions for any future intern so that there may be no hurdles along the internship journey.

1.3.4. Areas of Improvement for SME Foundation internship experience

These are some of the ways the organization can help upcoming interns to have a better experience

- SME Foundation can formalize a specific set of duties and responsibilities for its future interns so that they become less perplexed at the beginning of the internship program and emphasize preparing for their work more conveniently.
- The organization (supervisor) can arrange weekly or half-monthly meetings with their interns to know more about their experience and monitor progress in learning.
- SME foundation can provide Interns with personal IDs for easy entry and attendance purposes.
- Interns can be invited to online workshops for SMEs aside from regular office meetings with SME owners so that they can learn more about formal communication and client handling.
- Interns may also benefit from an office laptop for work purposes instead of having to carry their laptops to work every day.

Chapter 2: Organization Part: Overview, Operations and a Strategic Audit

2.1. Introduction

In this Chapter, I have shed light on different aspects of SME Foundation's performance, Its organizational structure, Values, and operational practices considering its different areas of work. The report provides an analysis of the financial condition and its effectiveness in implementing the SME policy 2019, being a non-profit Government organization.

2.2. Overview of SME foundation

SME Foundation is a company limited by guarantee registered under section 28 of the companies Act, 1994 as a not-for-profit organization. SME foundation was established to implement the SME policy of the people's republic of Bangladesh to improve the socio-economic arena by facilitating the establishment of SME businesses around the country and increasing the number of livelihood sources and self-employment. It was created by the initiative of the ministry of industries under company law-1994 as a non-profit organization and was officially published in the Bangladesh gazette in 2007 to make it publicly known. The major activities of the SME Foundation are implementation of SME Policy Strategies adopted by the Bangladesh Government, policy advocacy and intervention for the growth of SMEs, facilitating financial support for SMEs, providing skill development and capacity building training, facilitating adaptation with appropriate technologies and access to ICT, providing business support services, etc. It is mentionable here that the Foundation is working for the development of enterprises and entrepreneurs who belong to micro, small and medium categories as per Industrial Policy 2016. Besides the general support for the development of SMEs and entrepreneurs, the Foundation is providing diversified support to the existing and potential women entrepreneurs to position them in the mainstream business community.

2.2.1. Mission Vision and objectives

Vision: To Create livelihood, accelerate economic growth, and alleviate country-wide poverty through improving small and medium enterprises.

Mission: Continuously support existing small and medium industries through a wide variety of activities to face the challenges of a free-market economy and globalization.

Objectives:

1. Encouraging and assisting the growth and development of manufacturing and service industries for SMEs.
2. Assisting private sector organizations such as business chambers, associations, research organizations, universities, consultation businesses, and NGOs in planning, categorizing, and financing activities.
3. Providing SME medals to successful businesses for creating a healthy competitive atmosphere.
4. Creating poverty and growth-friendly environment for SMEs so that prospective entrepreneurs can avail services such as hassle-free approval of loans, data and information collection, consultation, knowledge on product design and quality assurance, marketing, etc.
5. To alleviate bureaucratic hindrances for SMEs by identifying and informing concerned authorities after adequate research and discussion.
6. Gradually transforming into a uniform help center where SMEs can complete Licensing and approval activities.
7. To create a more reliable database including SMEF services.
8. Conducting training, seminars, workshops, and technical discussions to improve the proficiency of SME owners and employees.
9. Encouraging procurement and ownership of innovative and affordable technologies in SME business and stepping out of old ones.

2.2.2. SME foundation Wings/divisions

There are 12 wings in total at the SME Foundation. These wings work in collaboration with each other to achieve common objectives. A few of the major functioning wings as given below

Business support services Wing

The business Support services wing supports the digital platform for marketing and helping in exporting products of the SMEs seeking assistance. This wing is responsible for organizing SME fairs and setting SME stalls at International Trade Fair. They also link SMEs to global platforms

to participate in global fairs around the world. Additionally, this wing accommodates operations of some SMEs through the Business incubation Centre.

Human Resource Development Wing

This wing carries out a demand-based training program for SME entrepreneurs throughout the country. This training is for both new entrepreneurship development skills. They also monitor the impact of training on SMEs' growth or failure.

Finance and Credit Services Wing

Disbursing Bangladesh Government's SME fund (stimulus package of 20 thousand crores) during COVID-19) through bank and NBFI credit agreements, Women entrepreneurship financing, maintaining and updating the SME loan information desk, and arranging seminars on SME finance-related issues are among the main tasks of this wing.

Policy advocacy wing:

The formalization of informal SME businesses through different programs is the main purpose of this wing. This wing arranges round-table discussions with entrepreneurs to convince them in adopting formal business practices such as adhering to accounting methods, capital market inclusion, employee benefit, safety assurance, etc.

Public Relation Wing

This wing arranges TV and radio shows on current SME issues and activities with board members, SME officials, and entrepreneurs. They also publish report and SME foundation success stories and publicizes the yearly SME product fairs.

Cluster Development wing

In 2013, research and Government agencies has identified 177 clusters that are geographically and product-wise interconnected around Bangladesh. Since then, this wing has started cluster-based work such as making a directory of businesses in each cluster, advocating infrastructural development of clusters, and exhibiting cluster products.

2.2.3. SMEF's Recent Achievements

Digital database development: At the start of 2022, the SME Foundation has finally made the first step in making an SME database which was a precondition of its functionality and had been promised by the organization for a long time. The pilot project for completing the digital database had already taken off which is to be run in four Upazillas where R&D employees are constantly

collecting information and storing it in their digital database. As per the management, this decision can help in extracting important data to help covid struck businesses achieve resilience.

Quick Disbursement of Government loan incentive: During the 2020-21 fiscal year, SME Foundation was allocated Taka 300 Crore to disburse among SMEs via banks at 4% interest rates. Within 3 months of the Fiscal year, the whole amount was successfully disbursed to struggling Small and medium enterprises. As per the report of the board of directors, 3108 entrepreneurs from rural and remote areas (majority women) have received these loan incentives.

SME Human Resource Development: Since its introduction, SMEF has had 12000 training activities where more than 35000 SME entrepreneurs had partaken. Among these entrepreneurs, 60% were women as per the annual report. The pieces of training were conducted to increase skills in entrepreneurial development, Cluster-based proficiency development, Training of Trainers (ToT), Market research Product quality assurance, etc.

2.3. Organogram of SME foundation

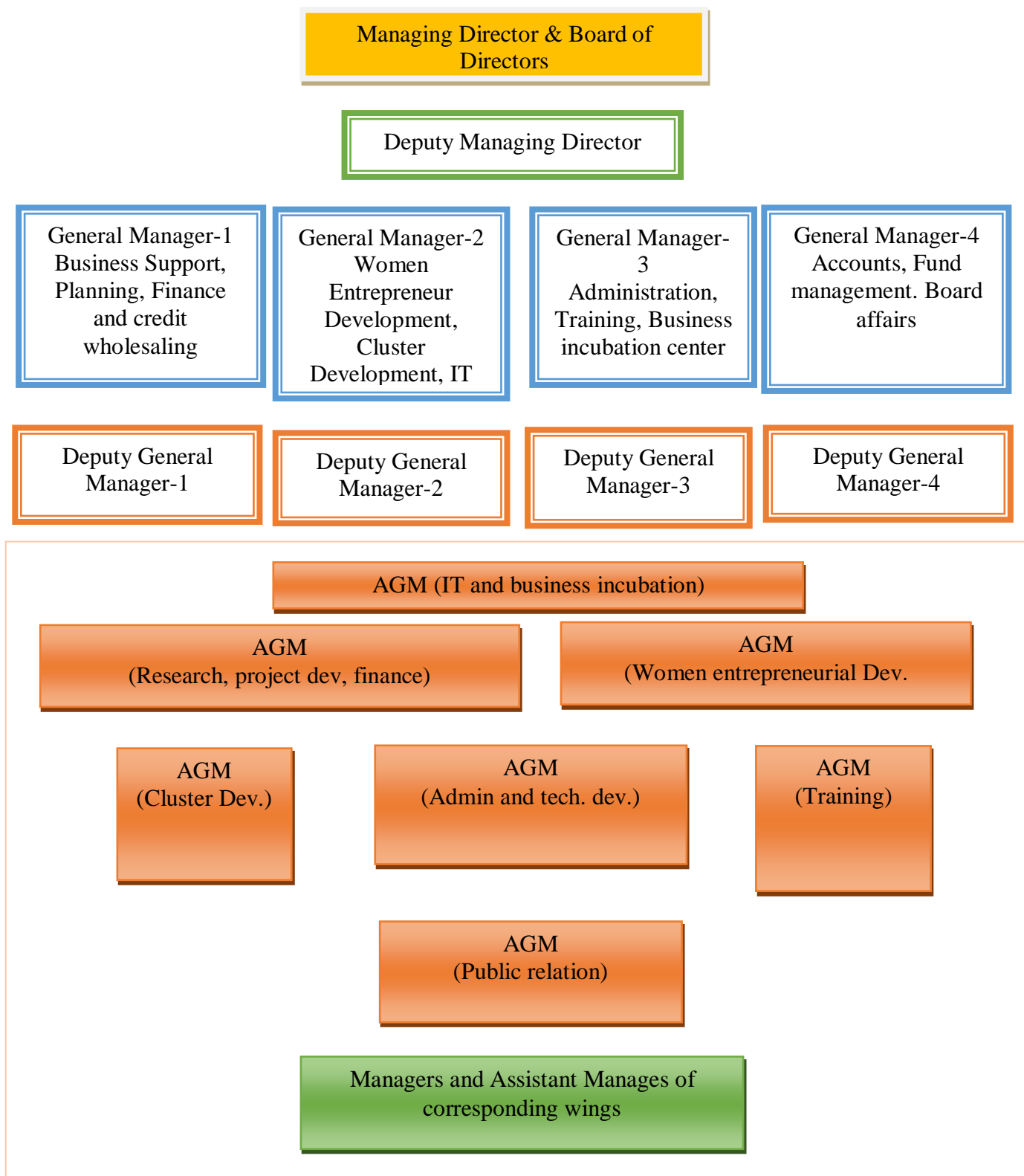


Figure 1: Organogram of SME foundation

2.4. Management Practices of SME foundation:

2.4.1. Leadership style

As per my observation, the SME Foundation has adopted a leadership style where Senior Officer's opinions carry more weight. Although there is no written form of confirmation, the reason I see it in such a way is that I have seen less open discussion on decision-making between the junior staff (e.g. Assistant general managers and lower title-holders and those who are deputy general managers and above). However, it should be mentioned that there is no visible hostility in this management setting, and seems to be working in harmony.

Apart from these, I have seen a very democratic relationship between the upper management. The General manager had welcomed thought on opinions on different matters such as resource allocation, training, workshop and seminars, and honorarium distribution from his immediate subordinates (Deputy GMs) and used these thought pools in actual decisions rather than just listening.

2.4.2 The Human resource planning process

Although SME Foundation had no separate division for carrying out HR management, the Admin, Training, Monitoring, and Evaluation wing generally takes care of these obligations. The HR management process is very since SME foundation is a very small organization having currently 47 employees in the main office at Agargaon and a few contractual titles in the fields/projects.

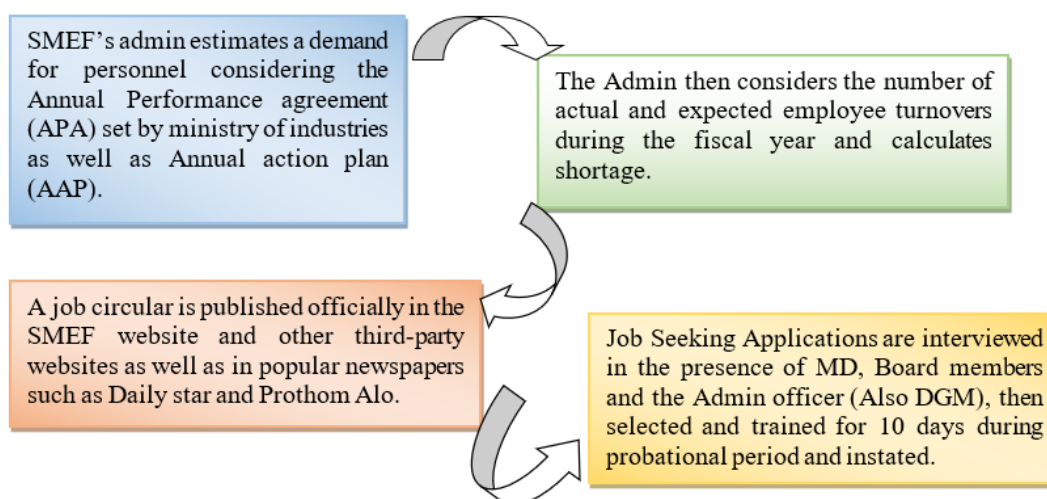


Figure 2: Hiring process at SME Foundation

2.5. SME foundation: Financial Performance and Accounting practices

SME foundation comparative financial statements and key financial ratios such as liquidity, fund usage, revenue generation trend, etc. are analyzed in this section. It should be mentioned that the SME foundation has no cost of equity since it is a non-profit organization and runs mostly on Government grants and endowment funds. Hence, the EVA, MVA, or other evaluation models do not apply to this organization. The measurement of SMEFs financial is measured here based on goal achievement activities of different wings of the organization.

2.5.1. Comparative Financial statement Analysis

Comparative Statement of Financial position (June 19-21)			
Particulars	% of Total Assets		
	30th June 2019	30th June 2020	30th June 2021
Assets			
Non-Current Assets			
Property, Plant and Equipment	0.39%	0.60%	0.18%
Work-in-Progress	0.03%	0.02%	0.02%
Current Assets			
Inventories	0.05%	0.05%	0.03%
Trade and other receivables	1.62%	1.48%	1.03%
Advances, Deposits and prepayments	7.64%	8.79%	7.02%
Investment in Credit Wholesaling	6.32%	4.11%	25.03%
Investment in FDR	77.26%	81.18%	66.46%
Cash and Cash Equivalents	6.46%	3.99%	0.23%
Total Assets	100.00%	100.00%	100.00%
Fund and Liabilities			
Funds			
Endowment Fund	50.22%	48.49%	38.45%
Reserve Fund	14.79%	15.70%	13.29%
Member's Contribution fund	0.00%	0.00%	0.00%
Balance of access of income	33.91%	34.41%	28.47%
Current Liabilities			
Trade and other payables	0.42%	0.29%	0.07%
Liability for expenses	0.64%	1.08%	0.34%
Liability for other Finance	0.02%	0.03%	0.01%
Total Funds and Liabilities	100.00%	100.00%	100.00%

Table 1: Comparative Financial statement Analysis

As observed in the Comparative statement of financial analysis above, the items of the income statement are shown as a percentage of the total asset to show the relative position of its assets, funds, and liabilities throughout the three years.

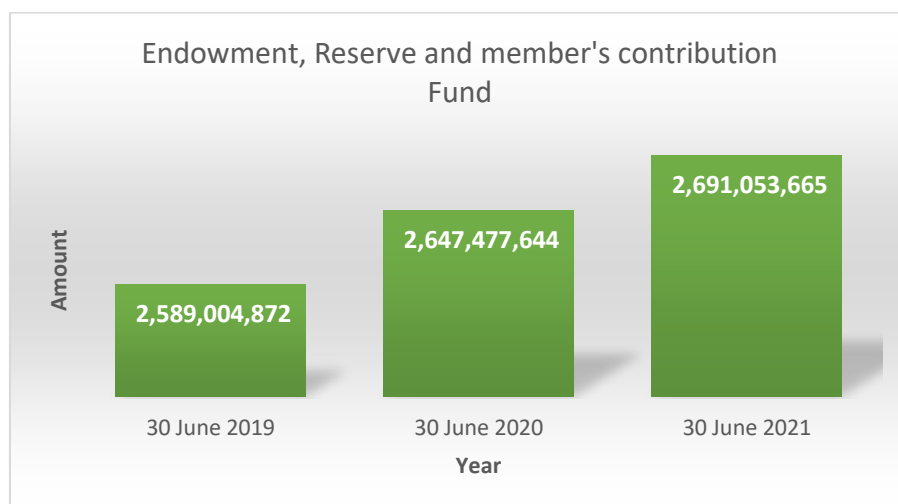


Figure 3: Endowment fund throughout 2019-21

As compared to 2019 SMEF had grown its property, and equipment from 0.39% to .60% of its corresponding year's assets. Although, there has been a drastic fall in the following year 2021, in the post-covid scenario where it dropped to 0.18%. When it comes to Credit wholesaling investment, we can see a significant rise in 2021 as compared to June 19-20. (25% against 4.11% and 6.32% in previous years). This indicates that SMEF has been more relaxed in aiding covid struck businesses with newly received Government grants in the fiscal year 20-21. Regards to Investments in FDR, it has decreased to around 66% which means more cash assets have been used for Financing activities for SMEF to SME enterprises.

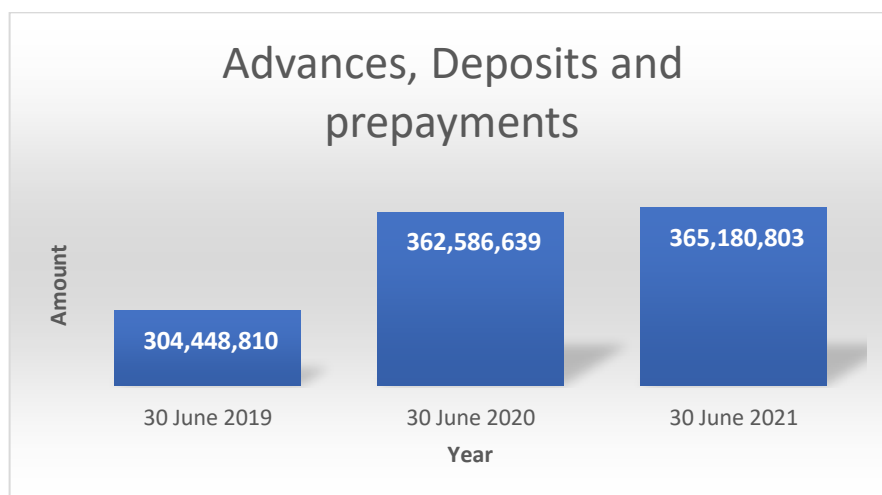


Figure 4: Advances and deposits throughout 2019-21

2.5.2. Comparative Statement of comprehensive Income

Particulars	% of Gross Income		
	30 th June 2019	30 th June 2020	30 th June 2021
Income			
Interest income	70.46%	96.93%	97.68%
Income from fair	1.58%	2.35%	0.02%
Income from Training	0.50%	0.43%	0.36%
Govt. Grants	27.34%	0.00%	0.00%
Other income	0.12%	0.29%	1.95%
Gross income	100.00%	100.00%	100.00%
LESS: Expenditure			
Operational Expenses	24.89%	34.51%	11.65%
Administrative Expenses	33.21%	44.58%	63.05%
Excess of income over Expenditure	41.90%	20.92%	25.30%

Table 2: Comparative Statement of comprehensive Income

The comparative statement of comprehensive income shows the income and expense items as a percentage of the gross yearly income. Here, income is mostly from Interests from the endowment fund of 200 crores. The government grant is provided to the organization every fiscal year as an Incentive to SMEs as mentioned in the SME policies.

As the statements show, the interest Income is relatively higher in 2021 than in previous years in proportion to gross income. This means there had been a lower amount of other sources of income such as Income from SME fair, Income from training, and Govt. Grants. Consistent with this data, we observe the lowest percentage of income from conducting SME fairs in 2021 which could be attributed to the impact of covid halting fair activities. Regards to Operational and Administrative expenses, we see a spike in 2020 and a noteworthy fall in 2021. In 2019, the excess of income over expenditure is the highest (44%) in three years due to the advantage of a Govt. grant during that year which was not the case for the following two years.

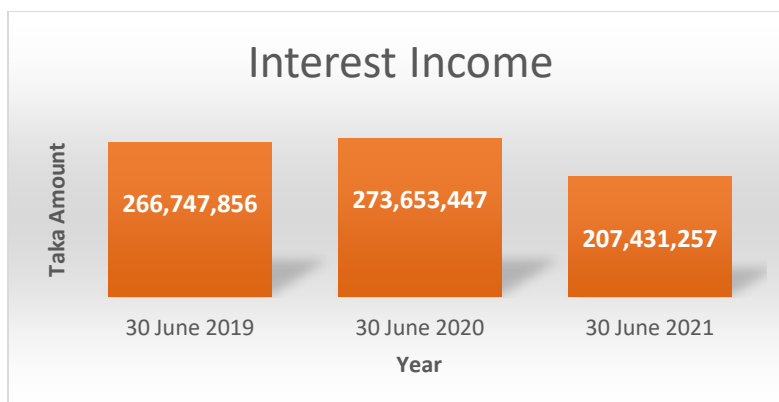


Figure 5: Interest Income throughout 2019-21

2.5.3. SME Foundation: Important financial ratios and performance indicators

Efficiency Ratio

Particulars	30 th June, 2019	30 th June, 2020	30 th June, 2021
Gross Income	275,099,961	282,331,307	212,362,912
Total Expenditure	219,951,777	223,273,240	158,644,717
Efficiency ratio	80%	79%	75%

Table 3: Efficiency Ratios

The efficiency ratio Shows SME foundation is showing a positive trend where it is visible that the amount of Expenses (operational and administrative) has been lowered as compared to its revenues generated from interest, fairs, training, and government grants Received. Lowering expenses means more cash and govt. fund is being used in facilitating SME enterprise-related objectives. Expenses have been cut down by 5% of its revenue in 2021 from 80% in 2021. As conventional wisdom goes for non-profit organizations, administrative and operating expenses should be lower as much as possible.

Return on Investment Activities

Particulars	30 June 2019	30 June 2020	30 June 2021
Total investment in FDR	3,328,327,749	3,517,886,898	4,758,251,497
Credit Wholesaling			
Collection from investment	295,452,853	261,490,396	198,670,244
Activities			
ROI	8.88%	7.43%	4.18%

Table 4: ROI

SMEF has only two types of Investment activities that are FDR and Credit wholesaling. The table illustrates the plummeting of ROI in 2021 to 4.18% from double the percentage in 2019 (8.88%). The recent fall in ROI could indicate the suffering state of SMEs and loan rescheduling in its credit wholesaling activity. Hence, The lower level of the collection led to a noteworthy decrease in ROI in the post-covid year 2021.

Income excess to expenditure/ Gross Income

Particulars	30 June	30 June	30 June
	2019	2020	2021
Gross Income	275,099,961	282,331,307	212,362,912
Excess of income over Expenditure	158,648,183	59,058,066	53,718,194
Income excess to expenditure/ Gross Income	57.67%	20.92%	25.30%

Table 5: % of Income excess to expenditure

The table shows the equivalent of the Net Profit Margin for a business entity for an SME foundation. It is evident that the NPM is lower in the following two years in comparison to 2019. (20.92% and 25.30% against 57.67%.) The difference can be attributed to the Interest income generation by capitalizing new govt. grant of BDT 10 Crore towards SMEF.

2.6. Marketing Practices of SME foundation:

SME foundation does not Have a Marketing division/wing. The main reason for the absence of marketing activities is that SME Foundation does not sell products and services that it has produced itself due to being a non-profit organization. However, the PR and Business services wing of SME Foundation is responsible for promoting SME products through SME fairs and international trade fairs.

SME foundation does not participate in fundraising activities such as seeking donations as well as asking for voluntary labor and services. For this reason, the use of a marketing department would only mean an unnecessary expense to Bangladesh Government's Endowment fund that may be used in SME facilitation services to reach its mission and vision. Hence, there is no formal marketing division apart from PR regularly promoting SME foundation services to SME owners through basic online platforms and TV show arrangements.

2.7. SME foundation's Operation Management and Information System

E-database plan for CMSMEs

Due to being a relatively small non-profit organization, SME Foundation only requires basic information system management software like MS excel to maintain its official data. However, due to the rising demand for SME data for research and decision-making purposes as well as Govt's plan on increasing SME contribution to GDP, SMEF has finally planned to start developing E-database with help of A2i. The pilot project is expected to start initially in four Upazillas of Bangladesh where SMEF will be collecting and storing data using the Respective union Digital center.

2.8. Conclusion and Recommendation

Because of the nature of SME foundations operations, it has a lot of potential to work with a larger number of SMEs in the Upcoming future. The satisfaction of the SME entrepreneurs and encouraging potential start-ups in the local arena will have to become widespread for the SME foundation to achieve its goals. SME Foundation has a sufficient amount of Govt grants and funds to further extend its operations. The most important factor for an SME foundation would be to increase its employee base since currently, it is very minimum. Moreover, It should put increase promotions of SME fair as much as possible as it had been disrupted during the First year of covid while impacting income from these activities.

Chapter-3: An observation of SME foundation promoting Capital market to SMEs in Bangladesh as an alternative source of financing through Qualified investor Offer (QIO).

3.1. Introduction

SME businesses consist of 25% contribution to Bangladesh's GDP and employ around 7.8 million making it the largest employment base (Chowdhury et al, 2013). Lack of collateral and a hefty amount of loan interest (as high as 14.44%) are seen to charge for SMEs in Bangladesh (Ali et al. 2018). Despite this exorbitant rate, 60% of SME entrepreneurs decide to initially take loans for both short-term and long-term financing whereas a huge portion of the rest follows suit due to a lack of convenience of alternative sources (Islam & Mia, 2018). Due to being considered as High risk by Bangladesh Bank and inability to comply with credit requirements and low access to the formal banking sector, SMEs also resort to informal services for working capital financing.

Earlier, On April 30, 2019, the DSE-SME, a small capital board was rolled out to facilitate finance for SMEs from the stock market. Since then, SME Foundation had various activities to encourage more SMEs to raise share capital and get listed on Exchanges. As a result, in October 2021, SIX SMEs initiated secondary trading at the DSE-SME board after completing a qualified investor offer. Although this is a drop in the bucket for achieving SME Foundation's objectives, it can be considered a good start ahead.

3.1.1. Literature Review

SME Foundation was established under the ministry of industries in 2007 and played a significant role in facilitating small, medium, and large-sized businesses to thrive throughout Bangladesh. As per the data from World Bank, the financing gap of SMEs in Bangladesh is USD 2.8 billion. SME foundation helps SMEs to raise funds at cheaper rates (4%) from banks and NBFIs, it has also the obligation to make SMEs compliant with business standards by convincing them to enter the capital market and maintaining proper accounting practices which fall under their "Policy advocacy" function. However, only 40% of SMEs show a hint of interest in getting listed on the Stock Exchange because of concerns such as accounting expenses for reporting compliance, Ownership dilution, and other trading barriers. Therefore, this study/observation

will explore more of such reasons for which they might be reluctant as present the existing modes of financing such as bank loans, NBFIs, informal debts, etc. to determine what incentives or circumstances would encourage them to shift more towards the Stock markets of Bangladesh. Stock market funding is necessary for businesses to grow and reap the benefits of prices going up as well as tax exemptions which many SMEs are missing out on.

3.1.2. Methodology:

For the purpose of this report, I have done a random sampling of 35 SME owners from the organization's contact list as well as the attendants of seminars and workshops of different events as the source of primary data. A semi-structured questionnaire had been prepared whereby responses were taken by neutral interpretation of the responses via group/one-to-one discussions. As secondary data, I have used recent journal papers on SME financing and accounting practices published after 2018 by academicians.

The other sources of secondary data are Bangladesh Bank publications, Annual reports (2019-2020) of several commercial banks to measure the SME lending activities, library documents of SME foundation to reflect on its contribution and observation of SME behaviors, etc. I have also used the opinions and observations of some employees in the R&D wing to elaborate on the issues related to SME financing.

3.1.3. Objectives:

Broad Objectives:

The Broad Objective of this report is to analyze the compatibility and preferences of SMEs in Bangladesh in raising funds from the capital market. Moreover, the report also aims to present data on the current SME financing scenarios and recent activities by SME Foundation and BSEC to help SMEs raise capital from the capital market.

Specific Objectives:

1. To identify how much banks are being utilized to raise capital for SME businesses other than the capital market in recent years.
2. Finding the extent to which Medium and Large businesses are hesitant to raise capital from the share market and what are the prime reasons behind it.
3. Identifying the advantages of SMEs participating in the capital market.

4. Ways in which SME Foundation is promoting share market capital to SMEs in Bangladesh through QUALIFIED INVESTOR OFFER.
5. To understand the procedures SMEs have to go through for issuing Shares via QUALIFIED INVESTOR OFFER.

3.1.4. Limitations

While creating this report, I couldn't find reliable secondary sources of data for informal financing activities of SMEs in Bangladesh which could help in comparing the cost of financing to the formal sector. Secondly, this report is based on my mediocre understanding of the overall financing scenario of SMEs in Bangladesh and I had limited analytical skills to make it more professional by using sophisticated statistical models.

Thirdly, at the time of collecting data from SME owners at SME foundation meetings and through collected contacts, it was hard to collect answers from the respondents to the questions in the questionnaire since many of them had limited knowledge of the capital market and would more often state some irrelevant or incomprehensive opinions.

3.2. Findings and analysis

To explain the issue the financing SMEs, it is necessary to define the nature and size of these enterprises. Each type of enterprise is composed of three sectors are Service sector, the business sector, and Industrial Sector. The following table shows the threshold of Assets and Number of Employees for a business to be considered as either small or medium.

Sector	Fixed Asset except for land & real estate property (Small Enterprises)	Employees
Service	50 thousand - 50 lac	25
Business	50 thousand - 50 lac	25
Industrial	50 thousand – 1.5 Crore	50
Fixed Asset except for land & real estate property (Medium Enterprises)		
Service	50 lac - 10 crore	50
Business	50 lac - 10 crore	50
Industrial	1.5 crore - 20 crore	150

Table 6: SMEs in Bangladesh: Asset size and Employees (source: BB)

3.2.1. Prominent Sources of SME financing

SMEs in Bangladesh had so far been largely detached from the formal source of financing such as banks and the capital market. Microservices and development assistance have found the following data regarding the sources of finance considering the total amount of capital raised.

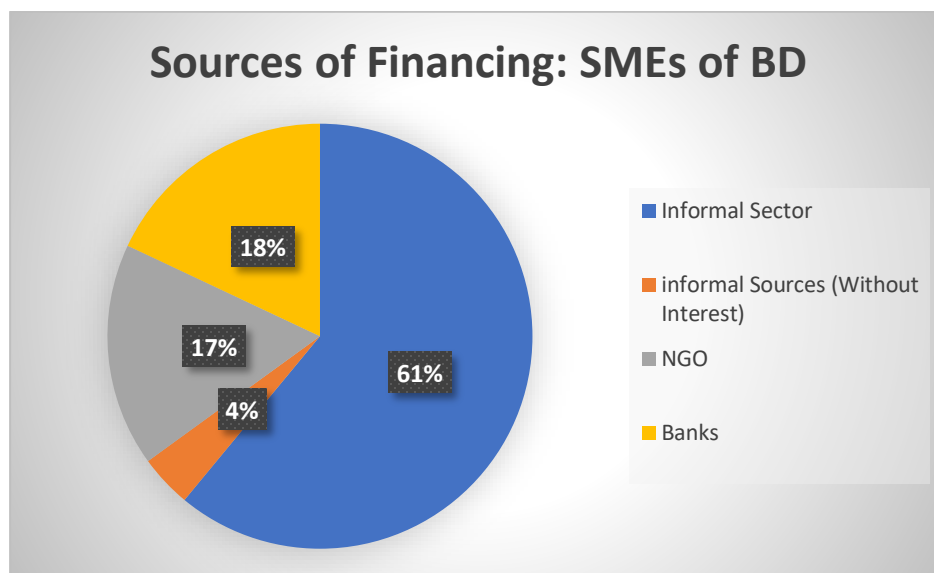


Figure 6: Sources of SME financing in Bangladesh (source: SMEF publication)

Here we can see SMEs mostly prefer to raise money from informal sources. Informal sources are those from family, friends, and relatives which can be both with or without interest and there is usually no written agreement between the two parties. However, It is yet to find the cost of financing from informal sources that require an interest payment. Besides Banks and NGOs make up less than half of the total SME capital. Hence it is visible that there are many limitations to financing from these sources.

SME Financing activities of some of the major banks in Bangladesh			
During the year – 2020			
Banks	Amount (Millions)	No. of SMEs disbursed in	Percentage of the total loan
Sonali Bank	74,402	33,586	12.16%
BRAC Bank	134,621	145,972	49.30%
Prime Bank	29,118	2,388	12.53%
DBBL	35429	N.M.	13.72%

Standard chartered Bank	10,295	N.M	4.76%
JBL	11,483	N.M	3.68%

Source: Annual Reports of respective Banks

Table 7: SME financing activities of prominent Banks in BD.

In the given table, we can see the number of loans disbursed to SMEs by a few of the top banks in Bangladesh. Most of the banks are indifferent to SME lending due to many factors except BRAC bank. Besides Banks and NGOs make up less than half of the total capital. Hence it is visible that there are many limitations to financing from these sources. The following table shows the distribution of 35 SME respondents' choices of financing from Banks.

As an entrepreneur would you currently choose a bank loan as your primary source of capital?	Number	Percentage
Yes	23	65.71%
No	12	34.29%

Source: a survey from contacts and discussion at SMEF

Table 8: Preference for Bank loan financing for SMEs

The data shows that 65.71% of SME businessmen are willing to take bank credit. Therefore, there is a clear indication that bank financing is not occurring at maximum capacity. However, many commercial banks have started or already developed specialized SME branches to expand lending in this area.

3.2.2. Challenges and obstacles in SME Financing

The following issues have been observed to restrict SMEs in Bangladesh to fully and conveniently finance through Banks.

The following data is collected from interviewing the same 35 respondents which shows the most significant factor (which causes the highest impact) for the respondents while choosing SME loans. Expectedly, most respondents deemed high-interest rates to be the most troublesome factor (54% or 19/35 respondents). Among other respondents, the documentation process, collateral requirements and loan disbursement timing had been stated as well. These factors are explained as per Respondents' subjective statements and also relevant literature.

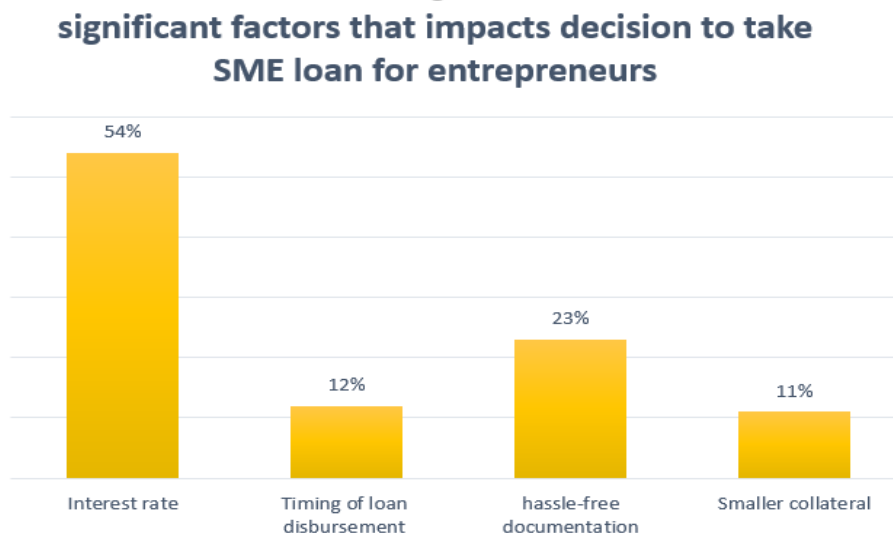


Figure 7: Factors that Impact the decision in taking SME loans

1. Limited Information at Banks for Risk-Measurement

Banks have an issue with lending to small and medium enterprises due to the absence of a proper legal and regulatory framework where the level of financial and non-financial information that is requisite in making a lending decision is not reliable. Moreover, many banks do not also have an effective system to quantify SME-related risk that weighs the risk of one SME against another to compare risks. Consequentially, Banks become more rigid with their credit terms. Another problem in the case of SME lending is the moral Hazard. Banks deem SMEs to be highly in their operations and taking greater risks than larger corporations.

2. High cost of Finance

The high cost of finance is a bottleneck for financing SMEs. Most SME entrepreneurs and running businesses do not take the interest and other arrangements of loans as borrower-friendly. Furthermore, the loan repayment schedule and the cash-flow cycle of SME businesses are separated by their nature (for example different crop production in different seasons may be different in yielding sales than a cold storage company or a poultry firm.). hence, the inflexibility in the term of loan repayment is a big hindrance in bank lending. According to a Rajshahi University study by Ali and Islam published on researchgate.net, SMEs in Bangladesh are having to pay around 14.5% to institutional lenders and around 32% to non-institutional (Mostly informal) lenders. For this exorbitant cost of financing, many SMEs are facing huge stagnation on the way to full-fledged growth.

3. The collateral requisite is too high

By definition, SMEs have lower fixed assets. Since banks measure loans risk-based loan amount backed by assets, SMEs are insisted by banks to have a higher value in Fixed asset accounts (properties, plants, owned equipment). Also, banks in Bangladesh do not maintain consistency in receiving similar kinds of collateral such as contracts of projects or even sales and inventories which they would in the case of large corporations. Additionally, SMEs initially need more loans compared to their little amount of assets although the loan amount is generally less than the collateral offered.

4. Banks don't have a credit record

Credit rating agencies in Bangladesh are not that active in tracking the credit record of a huge number of SMEs throughout the country. Also, due to the frequent use of the informal sector of funding, there is little to no digital record of loan/credit repayment. This does not help banks to make a credit model because of this data insufficiency.

5. Location of banks and their reach to SMEs at the local level

The spread of bank offices that process loan request are very limited in the rural areas and towns. Despite the huge \$2.8 gap in SME financing, banks in our country are yet to serve SMEs in adequate numbers. In addition, many rural SME owners are unaware of loan facilities or either anxious to apply for loans in some unwelcoming environment. So, lack of approachability is also an issue.

3.2.3. SME foundation promoting financing from Capital Market via Qualified Investor

Offer (QIO)

On 6th September 2021, SME Foundation signed an MoU (Memorandum of understanding) with Bangladesh Securities and Exchange Commission where they will jointly help SMEs to raise capital market through qualified investor offer (QIO). Trading on Exchanges has increased with a rising number of listed companies since September 30, 2021, on a separate SME board (SCP) in the DSE and CSE.

Qualified investor offer:

Similar to an Initial public offering or RPO, QIO is a new form of raising equity capital for small and medium enterprises. Here, the issuers (SMEs) securities are offered to qualified Investors (QI) as defined by the QIO issue rules 2018 by BSEC. This offering is exclusive to “Small capital

companies” using the small capital platform (SCP) in the capital market. The qualified investors are people of the following wealth or profession:

- i. Merchant bankers and Portfolio managers
- ii. Asset managers
- iii. Mutual fund managers
- iv. Stock dealer
- v. Banks
- vi. Financial institutions
- vii. Insurance companies
- viii. Fund managers
- ix. Alternative investment funds
- x. Foreign investors with an investment portfolio in the capital market of Bangladesh
- xi. Market makers
- xii. The issuer of listed securities
- xiii. Bangladeshi (Resident or non-resident) individual having a net worth of more than Taka 1 crore (10 million)
- xiv. Other categories as approved by BSEC

Like IPO, Capital Raising through QIO can be in either the “Fixed price method” or “Book building method” where it can be initially offered above par value. The QIO can be repeated until the business has a paid-up capital of a maximum of 30 crores. Until this amount, the stock would have under a separate board for SMEs. However, reaching a 3-crore amount the business will no longer be considered an SME be eligible to apply and be listed on the main board with other corporations. Hence, the shares can be offered in IPO to the general population/investors.

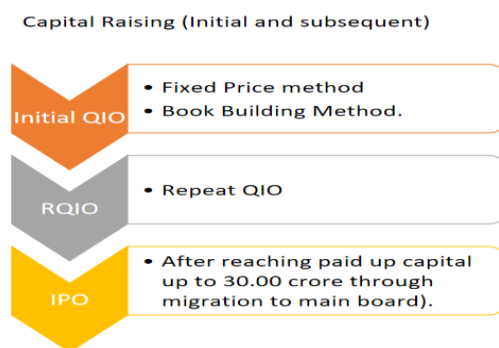


Figure 8: Stages of QIO to IPO.

SME foundation Helps in the documentation and advocacy of Capital market participation through its Finance and Credit wing. They call in new and existing SME businessmen in a formal meeting with the issuance manager wherein the issuance manager with the assistance of SME foundation employees pitches the formal procedures as well as the pros and cons of listing with the stock exchanges for SMEs. After being done with the meeting, potential and willing owners signup with SME Foundation and SME foundation offer them alternative choices of Issue manager from different investment banks. The formal documentation process commences from this point forward whereby SME foundation staff and the Issue manager work hand in hand.

3.2.4. The process followed for listing under QIO for SMEs

To issue under QIO, an SME has to first decide on either a fixed price method or book building method of pricing its shares. SMEs in Bangladesh must have a minimum Pre-issue paid-up capital of 10 crores to issue shares in the book-building method as per the rules of BSEC. However, all the Six SMEs listed under QIO have followed the fixed price method due to not individually having this amount of paid-up capital yet as of June 2022. The flowchart for the QIO listing goes as below

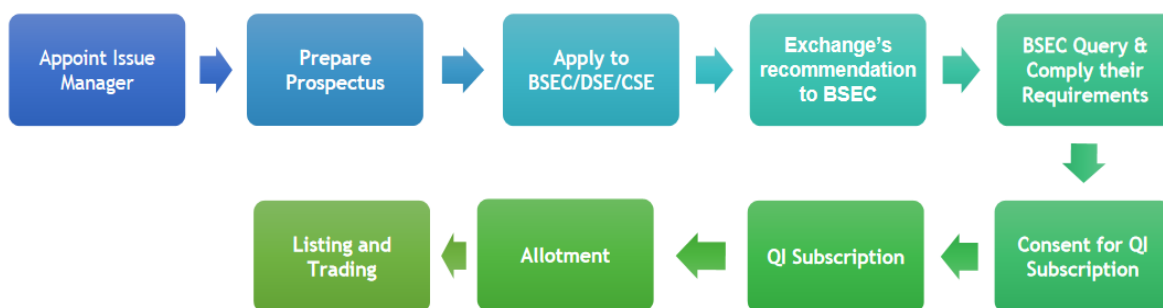


Figure 9: Flow chart for QIO listing under fixed price method

To be granted consent from either of the two stock exchanges (DSE or CSE) for a QIO subscription, an SME has to appoint an issue manager. Only after Consent, the Investors (qualified) will be able to apply for issued securities. As per the “Bangladesh Securities and Exchange Commission (Qualified Investor Offer by Small Capital Companies) Rule, 2018”, The maximum an issue manager can change an SME for listing through Fixed Price Method is BDT 3 lacs. The main pre-requisites before proceeding with the Application for the Issuers are as shown below.

- The issuer must receive at least 50% money of the QIO securities from its underwriter.

- The valuation of the SMEs assets should be done as per the guidelines for BSECs rules for Small Capital Companies from time to time.
- Financial statements of the SME should be older than 120 days to reflect the recent performance and there should be a positive net profit (NPAT) for the SME for the last two financial years of that SME.
- The accounting dept should adhere to the IFRS or IAS rules for SMEs for these required Financial statements.
- The SME should do a cost audit for these Financial statements by professional Accountants as per the company act 1994 and the latest financial statements (last 2 years) shall be audited by the panel auditors of Bangladesh Securities and Exchange Commission.

The issue manager has to apply for the consent of QIO from BSEC. The issue manager appointed should be responsible to ensure that all requirements are complied with before submitting the red-herring prospectus (draft prospectus) for QIO by the Issuer to BSEC along with the issuer's audited financial statements. After the issuer applies for QIO subscription consent from BSEC, it can publish the official prospectus online, and to DSE and/or CSE.

After receiving the prospectus, DSE/CSE creates a checklist to list that the Issuing SME has submitted all the required documents and makes a primary recommendation to the BSEC. BSEC verifies the application and documents submitted and may also ask for additional papers such as certification of auditors, clarification and disclosure of financial matters, etc. If BSEC does not seek any further documents from the SME, the DSE and/or CSE may submit their final recommendation within 60 days of the application. Hence, BSEC decides either to allow or dismiss the application for QIO consent by the issuer.

After getting consent, the subscription starts where qualified investors can apply for a maximum of 10% of the SME securities issued. However, if more than 50% of the securities are unsubscribed, the QIO will be canceled.

All the six SMEs listed under QIO had to carry the following expenses

Observation:

In my observation, there could be several obstacles to compliance for applying to issue under QIO for SMEs in Bangladesh. Firstly, the accounting information system practices (AIS) for a large number of SMEs are found to be inadequate. According to a study by Ismail Hossain and Maj

Ferdousur Rahman in 2019, only 10% of respondents admitted to keeping an Income statement whereas 90% of the respondents admitted to only maintaining Cashbook. None of the respondents kept journals, ledgers and balance sheets. This suggests that SMEs in Bangladesh generally do not follow IAS or IFRS accounting standards for SMEs causing them issues such as separating business and personal transactional issues for the small enterprises, not being able to identify all the expenses properly and state actual revenue.

Secondly, the cost of issue managers, the rigorous documentation requirements by BSEC, complying with conditions such as bearing auditing costs, employing professional accountants to record financial statements accordingly, and reaching agreeableness between partners are huge issues for SMEs to overcome issue under QIO.

Thirdly, many investors in Bangladesh are reluctant to invest in smaller organizations as SMEs' shares will primarily not be listed on the main board of the exchanges with larger corporations until they reach a capital threshold of BDT 30 crore. Hence, there is always a risk of unsubscribing and QIO being canceled due to the poor sentiment of investors in this sector.

Particular	Fixed Price
Issue management fee	Maximum Tk. 3,00,000
Underwriting fee	Maximum 0.25% of the amount underwritten.
Application fee for the Commission	Tk. 5,000.00 (non-refundable)
Prospectus scrutiny fee for DSE	Tk. 25,000.00 (non-refundable)
Consent fee for the Commission	Tk. 10,000.00
Depository fee for new issue	0.00015 of the total paid-up capital.

Table 9: Expenses for listing in the Exchange under QIO.

3.2.5. SME Entrepreneur's Preferences on joining Capital market

Partaking in capital market fundraising has many perks. As promoted by SME Foundation, SMEs can capitalize on their goodwill through shares and benefit from a rise in share price which would not have been possible in other forms of financing. Moreover, SMEs that enter the capital market are granted tax incentives (Reduced Tax rate). Through QIO, SMEs can increase credibility with Banks, suppliers, and even their customers which are largely problematic for small and medium-sized businesses with limited activities in marketing and lack of capital. Hence, they will become more eligible for bank credit.

Even though these benefits are very attractive for SMEs, there is reluctance in opinion from SME owners. There are as shown below along with data. Many participants in the interview have raised questions about sharing information that serves as a competitive advantage to their SMEs. Many non-disclosure agreements help create good relationships with larger corporations that use SMEs as a backend source of supplies.

Another significant issue of the SMEs is their lack of Capital market knowledge leading them to believe that any certain percentage of ownership dilution (in the case of shares) will break their stronghold in ownership.

To what extent do the following factors influence your choice to participate in the capital market?	
<u>Factors</u>	<u>Average rating (1-5)</u>
Lack of confidentiality	Moderately Agreed (3.45 avg)
Dilution of ownership Control	Firmly Agreed (4.40 avg)
investor relation and communication	Moderately Agreed (3.24 avg)
Cost of accounting and auditing	Firmly Agreed (4.5 avg)

Table 10: Particulars aspects that impact SMEs in joining Capital Market

Moreover, entrepreneurs also worry about managing proper communication with investors and holding board meetings and AGMs as required by BSEC due to their lack of a professional workforce. Lastly, many SMEs Before applying to QIO may not have a proper accounting system in place and thus necessitating a team of professional accountants who cost relatively higher than their administrative budget.

3.2.6. Overall view of SMEs currently trading under QIO

The following representation portrays the amount of paid-up capital of the 6 SMEs that have subscribed to QIO and started trading at CSE.

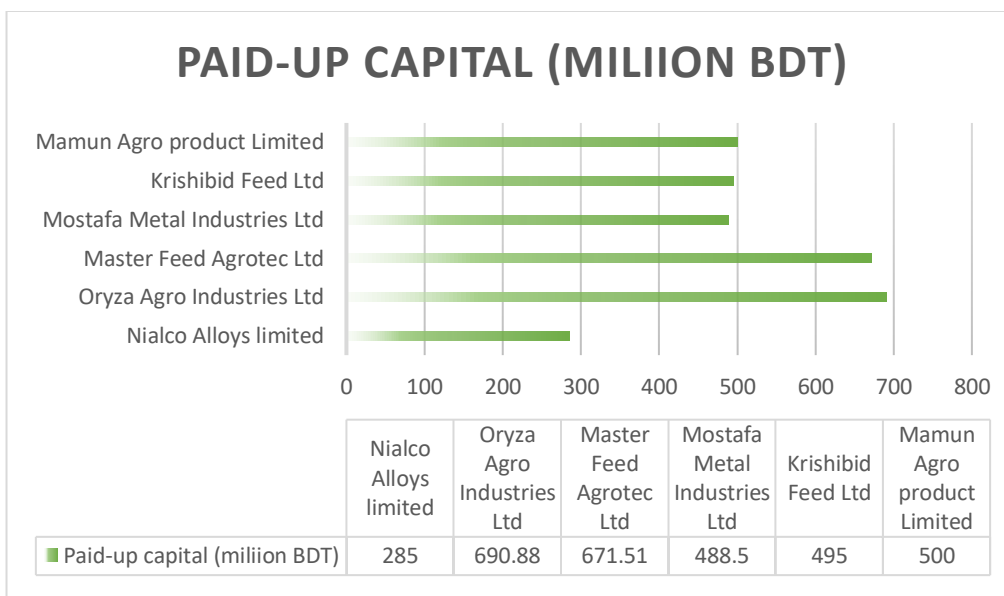


Figure 10: Paid-up capital of QIO issuers (CSE website)

So far SMEs have raised BDT 3130.89 million worth of capital. All the SMEs had opted for the Fixed price method with a face value of 10 takas each. The reason for choosing the fixed price method of pricing stock could be attributed to the lower cost of the Issue Manager fee for all the formalities such as bidding and also fixed cost method takes approximately half the time to list (6 months as opposed to 1 year according to BSEC guidelines for QIO). It is highlighted in this section because SMEs have all shown a tendency of cost-saving to list in exchanges as much as possible.

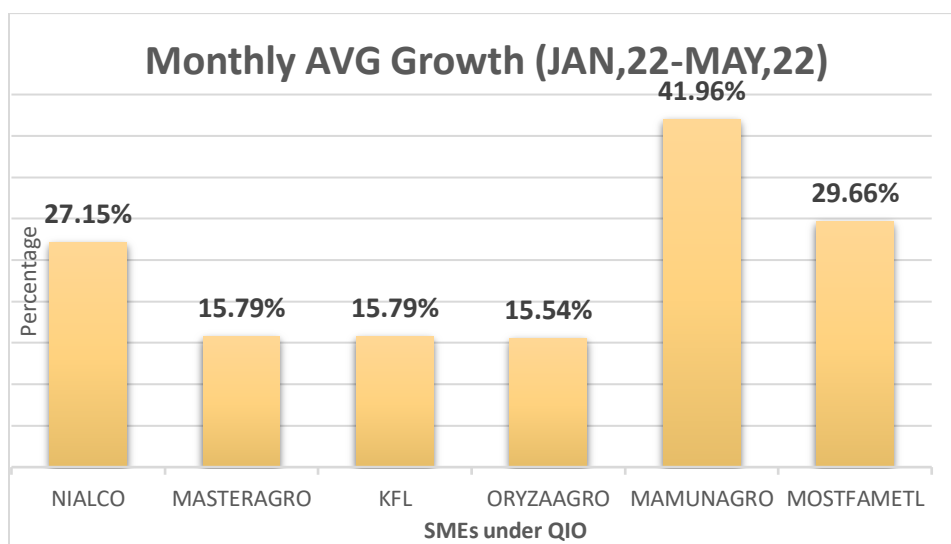


Figure 11: Monthly average growth of the 6 issuers under QIO. (CSE)

The six SMEs have all seen a significant rise in their stock value since their debut trading date. The graph above depicts the average monthly growth rate of the six QIO issuers. Here, Mamun Agro products limited has seen the highest average growth of 41.96% which is the result of a drastic price boost of 125% during march-April (last day closing price as shown in Appendix). NIALCO and MOSTAFATL are following the rank with 27.15% and 29.66% Monthly average growth although being comparatively earlier to enter the stock exchange. The Other three SMEs have more or less similar share price growth of around 15%. Observing these growths, it can be said that Qualified investors will logically be attracted to these SMEs in CSE and consequently the market cap of these shares will rise even further.

3.3. Conclusion and Recommendations

Despite the Start for SMEs in Bangladesh to enroll in the capital market, there are only a few SMEs that are seemingly aware of this opportunity. Hence, SME Foundation's Finance and Credit wing has a huge target to engage SMEs to see the benefits of growth and easy financing through the capital market. My recommendation is to ensure that SME Foundation can make the process for QIO easier by collaborating with BSEC so that these Businesses can take the benefit of quick financing as compared to bank loan which takes a long time to approve. Without it, SMEs may not be genuinely interested to put the time and effort as well as cost into entering the capital market. Furthermore, the fees related to investment banks could be partially subsidized to encourage relatively Smaller SMEs to participate.

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Appendix

Questionnaire for interview and group discussions:

➤ *As an entrepreneur would you currently choose a bank loan as your primary source of capital?*

- YES
- NO

➤ *Which of the following factors do you believe to have the most impact while deciding to finance through a bank loan?*

- Interest Rate
- Loan timing
- Requisite Collateral
- Documentation Process

➤ *To what extent, the factors are most convincing to you to raise funds from the Capital market for your SMEs?*

- Increased credibility and higher probability to receive Credit from financial institutions

1	2	3	4	5
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- Tax incentive (reduced cost)

1	2	3	4	5
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- More diversified Investor participation

1	2	3	4	5
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- Easier access to funds than Bank debt capital.

1	2	3	4	5
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➤ For which of the following factors, you may not decide to raise capital from the Capital market? (you may choose more than one)

- There will be an obligation to disclose confidential information to BSEC.
- Ownership will be diluted
- It is hard the manage relationships will investors through QIO
- Fees for issuing shares are too high

Average Monthly Growth Calculation**NIALCO**

Month	BDT	Growth
JANUARY	BDT 14.40	
FEBRUARY	BDT 13.60	-5.56%
MARCH	BDT 19.70	44.85%
APRIL	BDT 37.60	90.86%
MAY	BDT 29.50	-21.54%
Average Monthly Growth		27.15%

MASTERAGRO

Month	BDT	Growth
JANUARY	BDT 10.00	
FEBRUARY	BDT 11.20	12.00%
MARCH	BDT 11.20	0.00%
APRIL	BDT 20.20	89.29%
MAY	BDT 12.50	-38.12%
Average Monthly Growth		15.79%

KFL

Month	BDT	Growth
JANUARY	BDT 10.00	
FEBRUARY	BDT 10.30	3.00%
MARCH	BDT 10.20	-0.97%
APRIL	BDT 20.20	98.04%
MAY	BDT 10.40	-48.51%
Average Monthly Growth		12.89%

ORYZAAGRO

Month	BDT	Growth
JANUARY	BDT 10.40	
FEBRUARY	BDT 10.20	-1.92%
MARCH	BDT 10.30	0.98%
APRIL	BDT 18.00	74.76%
MAY	BDT 15.90	-11.67%
Average Monthly Growth		15.54%

MAMUNAGRO

Month	BDT	Growth
JANUARY	BDT -	
FEBRUARY	BDT 10.00	
MARCH	BDT 10.00	0.00%
APRIL	BDT 22.50	125.00%
MAY	BDT 22.70	0.89%
Average Monthly Growth		41.96%

MOSTFAMETL

Month	BDT	Growth
JANUARY	BDT 10.00	
FEBRUARY	BDT 11.90	19.00%
MARCH	BDT 11.00	-7.56%
APRIL	BDT 24.50	122.73%
MAY	BDT 20.70	-15.51%
Average Monthly Growth		29.66%