



INTERNSHIP REPORT

ON

**“SME Financing for Small and Middle Entrepreneurs in Bangladesh:
Reviewing from the perspective of BRAC Bank Ltd.”**





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Subject: Internship Report Submission

Dear Ma'am,

With due respect, I have the pleasure to submit my internship report on “**SME Financing for Small and Middle Entrepreneurs in Bangladesh: Reviewing from the perspective of BRAC Bank Ltd.**” to fulfill the requirement of the bachelor degree under your supervision. It has been a worthwhile experience for me undertaking such a report work to get exposure to the real life of a banking organization.

I tried my level best to put meticulous effort for the preparation of this report. Any shortcomings or flaw may arise as I am very much novice in this aspect. I will wholeheartedly welcome any clarification and suggestion about any view and conception disseminated in my report.

Sincerely yours

Nilanjana Halder

ID- 08304006

BRAC Business School

BRAC University

Acknowledgement

It is necessary to know the consequence between theory and practical knowledge as well. So, a student can only claim himself as a student of true knowledge by high caliber of preparing such kind of financial report.

First and foremost, all praises to almighty God who has created me and has given me opportunities and strength to work with people. Then I would like to thank my academic supervisor Kulsum Popy, Lecturer of BRAC Business School, BRAC University for offering valuable professional advice and guidance as well as kindness, endless patience and continuous encouragement.

I was placed t BRAC Bank Limited, Uttara Branch to work as an intern from the period of may 20th 2012 to August 14th 2012. I am grateful to Mr. Joyanta Kumer Saha, Customer Service Manager, and Uttara Branch of BRAC Bank Limited for his cooperation and necessary support throughout my internship period. Also I am thankful to those executives of BRAC BANK Ltd. who helped me a lot to make this report informative & successful.

At the same time I would like to thanks the Human Resource Department of BRAC BANK Ltd for providing me three days training period on BRAC BANK Ltd, its supportive wings and SME department which has enhance my knowledge about this promising and prominent financial institution of Bangladesh.

In addition, this study would not have been possible without continuous support, encouragement of my friends and all my family members.

Thankfully,

Nilanjana Halder

Executive Summary

Higher growth of the Small and Medium Enterprises (SMEs) can help cut poverty to a satisfactory level by eliminating various prejudices against labor intensive and creating jobs for the skilled manpower in the SME sector. However, the access to financing is still recognized as the leading obstacle to SME growth in Bangladesh, alike most other developing and under-developed countries. Small and medium entrepreneurship have a tremendous potential in empowering potential entrepreneurs and transforming society. To target this sector with huge potentiality BRAC Bank Ltd introduced SME Banking Unit in 2001.

BRAC bank was established in 2001 to work on “double bottom line approach” and currently it is operating all over the country having 46 SME/Agro Branches, 22 SMESCs, 152 branches, 313 ATMs, 399 SME Unit offices. This fastest growing bank works on people, planet and profit; ensures sustainable growth and largely focuses on SME financing sector.

BRAC Bank SME division was set up to capture “missing middle” and to create socio-economical impacts in the country. Within 10 years of establishing it has proved its success through becoming country’s largest SME finance provider and 4th large SME provider in the world in terms of lending volume.

However BRAC Bank has the country’s largest defaulter rate (in number). Even though strict loan approval system is maintained due to some unavoidable reason “bad-losses” sometimes occur. In order to reduce credit risk BRAC Bank follows consistent monitoring system upon borrower’s activities. Again if someone turns in to defaulter special wing called SAM works to enforce law.

For the inheriting business risk, SME sector is facing several constrains in terms of growth. Policy level complexity, financial constrains, legal bindings and industry structure are hindering financial institutions to support SME sector. Lack of SME supporters, poor infrastructure of the country, lack of entrepreneur’s skills, lender-borrower gap, huge market competitions are the major drawbacks for both borrowers and lenders. Again SME sector has tremendously contributed in the economy. Today it has been considered as the engine of country’s economy.

Being country's largest SME provider, BRAC Bank is facing several challenges which are identified in analytical part of the report. Business risk, high interest rate, high defaulter rate, certain government policy change ETC are the major challenges facing by BRAC Bank.

The recommendation part of the report tried to find out some steps could be initiated by BRAC Bank in order to overcome existing weakness. Lowering interest rate, more effective loan approval system, strong monitoring activities, and entrepreneurs meeting arrangement could improve BRAC bank's performance.

MY INTERNSHIP EXPERIENCE-

My internship at BRAC Bank Limited started on May 20th, 2012 and it ended on August 14th, 2012. During these 3 months I was assigned at the Uttara Branch. During this short period I have experienced real professional world and its manners. I have come to know several professional etiquettes, training manners and organization's behaviors. During this 90 days I have gone through following responsibilities-

- **Ensure quality service along with branch staffs-** I was assign to work with Branch sales and service Manager (BSSO) in order to ensure smooth and quality service providing to the customers. I had organized different files, forms and documents in such way so that the BSSOs could deliver prompt customer service. For example I helped the clients to fill up different remittance forms so that flawless remittance service can be delivering.
- **Coordinate with Different Departments-** One of my major duties was to coordinate with department through file and information's sharing. For example- I distributed different documents to the responsible person. At the same tome any general massage need to convey was done my.
- **Prepare daily reconciliations-** Every day I have contributed in preparing daily reconciliations paper of cheque books; sales pack (new account opening package); debit card and captured cards. I have contributed to prepare both physical and log sheet reconciliations. At the same time I also kept the entry of those products at the log sheet.

Some jobs specifically done by me-

- ✓ Guide customer as per requirement of service. Instruct them which person she/he should concern. Providing all kinds of general banking information to the customers.
- ✓ Quickly response with client's enquiries and issues.
- ✓ Distribution of different form such as FDR, Account Opening, KYC, Debit card requisition ETC.
- ✓ Effectively maintain different log sheets of checks books, Fund transfer, debit cards and captured cards. Through daily reconciliation I have contributed branch's audit process.

- ✓ Consult and connect with clients as per requirements of the staffs. For example- before giving any documents to the authorized person ensure with account holder in order to resolve fraudulent activities.
- ✓ Guide clients to prepare necessary documents for any banking activities.

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1.1 BACK GROUAND OF THE STUDY

BRAC Bank Ltd. was established in 2001 with a focus on the small business sector, operating with a “double bottom-line” agenda: a combination of profit and social responsibility. The bank also focused on relationship based banking, as it believes that the pursuit of profit and developmental goals are mutually reinforcing. This focus makes the bank to emphasize more on to explore and access market opportunities as well as build asset base to its clients conforming significant contribution to the profitability of the Bank.

The SME Banking unit goes beyond traditional banking and works as a business partner to entrepreneurs, building awareness, providing training, and arranging road shows to support and develop their businesses. The corporate mission of BRAC Bank Ltd is to ensure “**sustained growth in SME sector**”. In parallel with this goal, SME sector, the main concentrated area of the bank financing since its inception, comprises of more than 50% of total loans and advances. At present BRAC Bank Ltd has taken a segment oriented approach with special products for manufacturers, traders, suppliers, importers, distributors and women entrepreneurs to meet the diverse customer segment needs. Thus, it is gearing up small and medium industries in tremendous manner while contributing in poverty alleviation through economic growth, as well as employment generation on mass scale.

1.2 ORIGIN OF THE REPORT

This report is an internship report prepared as a partial requirement for the completion of the BBA (Bachelors in Business Administration) from BRAC Business School of BRAC University. This report has been prepared based on the practical experiences at BRAC Bank Limited, Uttara Branch from 20th May to 14th August 2012 and three days training session provided by Human Resource team of BRAC Bank Limited.

1.3 OBJECTIVE OF THE STUDY

The report has been prepared in order to provide a brief idea about the SME financing scenario of Bangladesh from the perspective of BRAC Bank Ltd. The broad objective and specific objectives of the report are given bellow-

Broad objective-

Broad objective of this study is to analysis the SME scenario of Bangladesh and to assess the performance of BRAC Bank Ltd in context of highly competitive market. Along with that the report will justify how SME is contributing in socio-economic development of the country.

Specific Objectives:

The report will work on some specific objectives. Those are as follows-

1. To provide a brief overview of BRAC Bank Ltd-
 - Background of BRAC Bank Ltd
 - Different divisions, wings, and subsidiaries of BRAC Bank Ltd.
 - SWOT analysis of BRAC Bank Ltd.
2. To present an overview of SME division of BRAC Bank Ltd-
 - Detail description of SME division of BRAC Bank Ltd
 - Operation Process of SME Loan Disbursement of BBL.
 - Risk management process and collection process of BRAC Bank Ltd.
3. To analysis overall SME financing scenario of Bangladesh-
 - To figure out constrains and problem faced by Bangladeshi SME sector.
 - To assess the social and economic impact of the SME sector.

4. To find out the problems, if any, that BRAC Bank Ltd. as well as clients is facing in SME financing for small and medium entrepreneurs and to suggest remedies for the problems encountered.

1.4 SCOPE OF REPORT

This report has been prepared on the basis of practical learning on SME financing of BRAC Bank Ltd. At the same time, huge chunk of data have been collected from several research papers, publications and newspapers. For that reason, this report becomes a source of valuable information related with BRAC Bank and its SME division. Moreover, findings of report (combined with problems and prospectus; constrains and contributions of SME) will give an overview of Bangladeshi SME sector. Explanatory research on SME, more publications and expert advice could enrich this paper. This paper could be use for further research by students or any researcher.

1.5 METHODOLOGY

Both the primary and secondary data are used to make the report more rich and informative.

Primary Sources-

- Open ended and close ended questions with borrowers.
- Face to face communication with the supervisor and employees of the BRAC Bank Ltd.

Secondary sources-

- Official Website of the Bank and bank records
- Different books, training papers, manuals etc. related to the topic.
- Different websites and publications, newspapers

Processing of Data-

After collection of the raw data, the following computer packages has been used in editing and processing the entire report-

- MS-Excel
- MS-Word
- MS PowerPoint

1.6 LIMITATIONS

The report faced following limitations-

1. Due to time constrain, this report could not be enrich with vast research.
2. Due to confidentiality, employees were reluctant to reveal necessary information's.
3. Much use-full resource would not access due to privacy and unwillingness of the researchers.

2.1 OVERVIEW OF BRAC Bank Ltd

BRAC Bank Ltd. is the leading SME financing bank in Bangladesh. Established in 2001, BRAC Bank is now ten years old and it has pioneered the small and medium enterprise (SME) banking. It is the largest SME bank in the country in terms of number and coverage of SME distribution channels, amount of loan disbursements, number of clients and so forth. BRAC Bank Ltd. is one of the largest operational commercial ventures of BRAC Bank Ltd. which is a pioneer in recognizing and tackling the many different realities of poverty.

With 46 SME/Agro Branches, 22 SMESCs, 152 branches, 313 ATMs, 399 SME Unit offices, 31 CDMs, 1500+ POS terminals, 1800 remittance points and 8,500+ (as on 30th June 2012) human resources across the country, BRAC Bank's operation now cuts across all segments and services in financial industry. With more than 1 Million Customers, the bank has already proved to be the largest SME financier in just 9 years of its operation in Bangladesh and continues to broaden its horizon into Retail, Corporate, SME, Probashi and other arenas of banking.

BRAC Bank Limited, with institutional shareholdings by BRAC, International Finance Corporation (IFC) and Shore Cap International has been the fastest growing Bank in 2004 and 2005. The Bank operates under a "double bottom line" agenda where profit and social responsibility go hand in hand as it strives towards a poverty free, enlightened Bangladesh

BRAC Bank is surviving in the large banking arena through its unique and competitive products and it is the only local bank providing 100% integrated on-line banking services. BRAC Bank Limited consists of four major business divisions namely Corporate Banking Division, Retail Banking Division, Small and Medium Enterprise (SME) and Foreign Trade & Treasury.

As fully operational Commercial Bank, BRAC Bank focuses on pursuing unexplored market niches in the Small and Medium Enterprise Business, which hitherto has remained largely untapped within the country. In the last six years of operation, the Bank has disbursed over BDT 144,467 million in loans to nearly 320,000 small and medium entrepreneurs. The management of the Bank believes that this sector of the economy can contribute the most to the rapid generation of employment in Bangladesh.

Within this short time the bank has been successful in positioning itself as progressive and dynamic financial institution in the country. It has able to create a unique image for itself and earned significant solution in the banking sector of the country as a bank with a difference. In the years ahead BRAC Bank expects to introduce many more services and products as well as add a wider network of SME unit offices, Retail Branches and ATMs across the country.

VISION

The vision of BRAC Bank Ltd Is *“Building a profitable and socially responsible financial institution focused on Markets and Business with growth potential, thereby assisting BRAC and stakeholders build a “just, enlightened, healthy, democratic and poverty free Bangladesh”.*

MISSION

BRAC Bank focuses on following missions-

- Sustained growth in Small & Medium Enterprise sector
- Continuous low-cost deposit Growth with controlled growth in retail assets.
- Corporate Assets to be funded through self-liability mobilization. Growth in Assets through syndications and investment in faster growing sectors.
- Continuous endeavors to increase non-funded income
- Keep our debt charges at 2% to maintain a steady profitable growth
- Achieve efficient synergies between the bank’s branches, SME unit offices and BRAC field offices for delivery of remittance and Bank’s other products and services
- Manage various lines of business in a full controlled environment with no compromise on service quality
- Keep a divers, far flung team fully controlled environment with no compromise on service quality.

GOALS

BRAC Bank will be the absolute market leader in the number of loans given to small and medium sized enterprises throughout Bangladesh. It will be a world-class organization in terms of service quality and establishing relationships that help its customers to develop and grow successfully. It will be the Bank of choice both for its employees and its customers, the model bank in this part of the world.

OBJECTIVES-

The objectives of BRAC Bank Limited are as follows:

- Building a strong customer focused and relationship based on integrity, superior service.
- To create an honest, open and enabling environment
- To strive for profit & sound growth
- To value the fact that they are the members of the BRAC family – committed to the creation of employment opportunities across Bangladesh.
- To relentless in pursuit of business innovation and improvement
- To base recognition and reward on performance
- To responsible, trustworthy and law-abiding in all that we do
- To mobilize the savings and channeling it out as loan or advance as the company approve.
- To finance the international trade both in import and export.
- To develop the standard of living of the limited income group by providing Consumer Credit.
- To finance the industry, trade and commerce in both the conventional way and by offering customer friendly credit service.
- To encourage the new entrepreneurs for investment and thus to develop the country's industry sector and contribute to the economic development.

CORPORATE VALUES

BRAC Bank practices ‘ethical banking’ to create and maintain healthy banking environment. For that reason it has developed its External and Core values. External values focus on 3Ps. Those P’s are- **People, Planet and Profit**. On the other hand, Core values ensure each and every employee will be CRYSTAL to the organization. Here-

- C stand for Creative- Every employee is expected to be creative.
- R stands for Reliable- Each and every employee will be reliable.
- Y expresses Youthfulness of the employees.
- S expresses Strong, means employees are strong enough to handle any difficulties.
- T locates Transparent; everybody will maintain transparency in each work.
- A stands for Accountability. Everybody will be accountable for his/her activities.
- L stands for Loyalty, means every employees will be loyal to the organization.

LOGO

The logo of BRAC Bank has been prepared keeping in mind the goal of the organization. The square structure of the logo means solid and strong. The Golden Color in the lower portion of the logo means that ‘Golden Bangladesh & her fertile land’. The Blue color in the upper portion means ‘the sky with enormous & unlimited opportunity’. The white colored curve means ‘Growth and Progress’. White circles in the blue color mean the flashing sun that gives light to everywhere.



Figure 2.1: Logo of BRAC Bank

2.2 SHAREHOLDING STRUCTURE

The shareholding structure of BRAC Bank Limited consists of different group with institutional shareholdings by BRAC, International Finance Corporation (IFC), Shore cap International and general public is also included through IPO. The present shareholder structure of BRAC Bank Ltd is as follows-

SHAREHOLDERS	PERCENTAGE
BRAC	43.77%
IFC	5.36%
Shore Cap International	.86%
General Publication Through IPO	49.63%
Non Resident Bangladeshis	.38%
Total	100%

Table 2.1: Present shareholder Structure of BRAC Bank Ltd

2.3 MANAGEMENT HIERARCHY OF BRAC BANK LIMITED

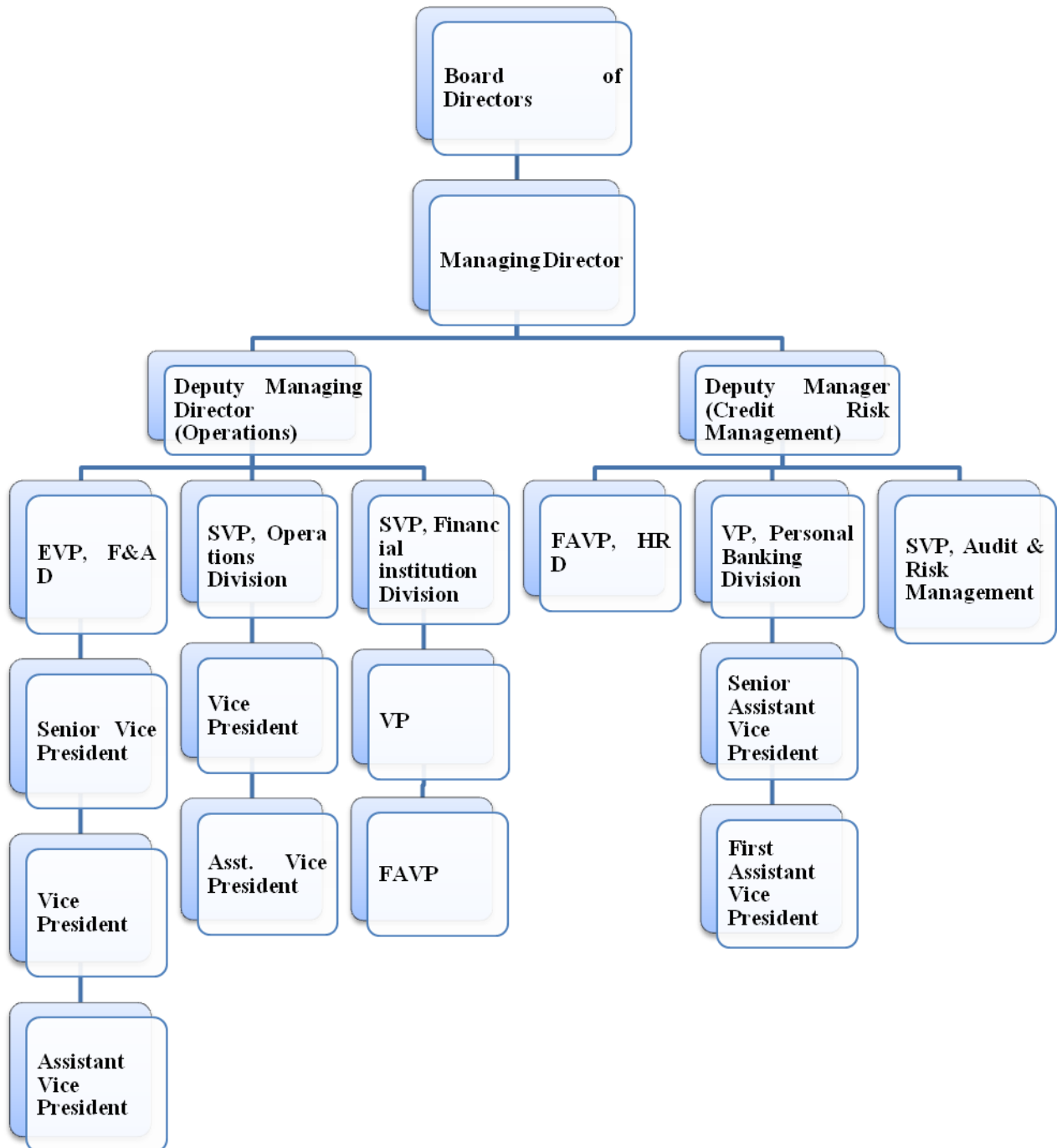


Figure – 2.2: Organization chart of BRAC Bank Limited

2.4 DEPARTMENTS OF BRAC BANK LTD

BRAC Bank has a very well organized and structured departmental chain. Each department is supportive and coordinative with others. Here main departments are supported by supportive department. However each and every process is done by centralized back office. For example- every loan file is approved or reject by central office, not from the regional office. The main departments of BRAC Bank are again separated in to two categories. Those are Whole sell and Retail banking.

Retail banking includes-

1. SME Division
2. Retail division
3. Corporate division

Whole sell banking includes-

1. Cash management
2. Probashi banking
3. Treasury and Custodial Service

The supportive wings are-

- Credit risk management (CRM)
- Finance department
- Technical department
- Human resource department
- Company Secretary and Legal Regulatory (CS & LR) department
- Research and Development (R&D)
- Corporate affairs
- Service quality
- Card division
- IT department
- Risk management division (RMD)

2.5 SUBSIDIARIES OF BRAC BANK LTD

BRAC Bank has different subsidiaries to support its banking system. All those subsidiaries are related with financial activities and serving to reach a broad number of customers. The subsidiaries are as follows-



According to BRAC Bank there are still 50% people are out of banking service. To reach to such huge chunk of people and bring them into banking service, bKash is working through mobile phone technology. The overall value proposition is simple: a safe, fast and convenient way to send and receive money.



BRAC Partners Limited (EPL) - It was founded by a diverse group of international fund managers and brokers from Bangkok, Hong Kong, London and Dhaka in October 1, 2009. It aims to increase the exposure of Bangladesh in the international fund management community. It has two different wings and those are-

BRAC EPL STOCK BROKERAGE LTD- Has developed a disciplined approach toward providing capital market services, including securities trading, wealth management and corporate advisory services.

BRAC EPL Merchant Bank- BRAC EPL delivers a whole range of Investment Banking services including traditional merchant banking activities along with offering investment services to non-residential Bangladeshis (NRB). It offers IPO's for its clients (organizes syndication if necessary). One of the remarkable IPO's offered by BRAC Merchant bank was Grameen Phone IPOs.



BRAC SAJAN- It's an exchange company incorporated in England and Wales. The Company mainly provides remittance services to the large Bangladeshi Communities living in UK. Apart from remittance services the Company also caters to the investment needs of the NRBs through its parent organization BRAC Bank.

2.6 DIVISIONS OF BRAC BANK LTD

BRAC Bank Limited consists of four major business divisions namely-

1. Corporate Banking Division
2. Retail Banking Division
3. Small and Medium Enterprise (SME)
4. Foreign Trade & Treasury

2.6.1 CORPORATE BANKING DIVISION

Corporate Division provides full range of commercial banking products and services to any potential corporate clients including multinationals, large or medium local corporate, NGOs, institutional bodies.

The Corporate Banking Division has a centralized structure through on-line banking system. Any credit facility is processed at the Corporate Banking Division, Head office. After sanctioning of the facility, the limit is put on line and the customer can enjoy the facility from any of the BRAC Bank branches. Strict adherence to internal control guidelines and other legal and statutory compliance are followed. The Credit approval process involves separate Credit Division, the Managing Director and finally the Board.

Other departments like Foreign Trade, Treasury, and Credit Administration etc. play the support role for a comprehensive range of service to the Corporate Banking Division.

2.6.2 RETAIL BANKING DIVISION

Retail Division offers a wide array of lucrative and competitive banking products to the individual customers of the bank. It offers different types of term deposit scheme and attractive STD & Savings deposit schemes giving interest on daily balance. Retail Banking Division has the following departments:

- ❖ Alternative Delivery Channels (ATM, Apon Somoy, Cash deposit machine (CDM), Phone banking, e-statement)
- ❖ Business Intelligence and Service Quality
- ❖ Cards Department
- ❖ Cross Selling and Distribution
- ❖ Non Funded Business
- ❖ Secured Value Centre and Unsecured Value Centre

Currently BRAC Bank has re-organized its retail business according to customer profile. This segmentation has been done to deliver more standardized services and reduce operating costs as well. The new segments are as follows-

Premium banking- Guest who maintains at least BDT 50 lacks (6 month average) is called premium customers. They are highly prioritized. They also enjoy different gift and discount through BRAC Bank. Currently BRAC Bank has around 1500 premium customers.

Supreme banking- Guest who maintain BDT 50 thousand and more (6 month average) are treated as supreme clients. They have separate service booth and cash deposited booth in the branch.

Excel banking- Client who maintains BDT 15 thousand in an average of 6 months are called excel group of guest.

Easy banking- These is the general customers who do day to day and traditional banking with the bank. They only require a minimum balance in the account.

2.6.3 SMALL AND MEDIUM ENTERPRISE (SME)

SME is an additional and specialized horizon of the bank which serves the bank's special focus on promoting broad based participation by catering to the small and medium entrepreneur. The network of SME has already been established throughout Bangladesh.

The SME market in Bangladesh is large. BRAC Bank is the absolute market leader in the number of loans given to small & medium enterprises throughout Bangladesh. The Bank disburses almost BDT 700crore of their loan to the SME unit. SME unit is dealing with small scale loan.

2.6.4 FOREIGN TRADE & TREASURY

Treasury Division is one of the major divisions of BRAC Bank. Treasury Division deals with money market. All treasury related products are processed in conformity with the Bank's Operational, Trading, Money market, Overnight, Term placing, Deal settlement, Commercial position keeping, Treasury, Credit, Finance & other applicable policies.

Treasury Operations calculates investment figure, prepares the auction application, forwards the application to Bangladesh Bank for Bid and Treasury Operations maintains and reconciles all accounts with foreign and local banks.

3.1 SMALL AND MEDIUM ENTERPRISES (SME) DEFINED

SME is defined as, “A firm managed in a personalized way by its owners or partners, which has only a small share of its market and is not sufficiently large to have access to the stock exchange for raising capital”. SME ordinarily have few accesses to formal channels of finance and depends primarily upon savings of their owners, their families & friends. Consequently, most SMEs are sole proprietorships & partnerships. As with all definitions, this one is not perfect. Depending on context therefore definition of SME will vary.

Despite the common features globally, countries do not use the same definition for classifying their SME sector. Also, a universal definition does not appear feasible or desirable. SMEs have been defined against various criteria. The three parameters that are generally applied by the Governments to define SMEs are:

- Capital investment in plant and machinery
- Number of workers employed
- Volume of production or turnover of business

Other definitions are based on whether the owner of the enterprise works alongside the workers, the degree of sophistication in management, and whether or not an enterprise lies in the "formal" sector. The definitions in use depend on the purposes these are required to serve according to the policies of the respective countries/Governments.

The SME sector of Bangladesh has developed steadily since early 1980s with the needs and demands of the economy. But until 1991 when the Industrial Policy’ was enacted, the SME sector did not get any attention from both government and private sector. In the latest Industrial Policy 2010, a distinction was made between manufacturing and non-manufacturing enterprises.

- In the manufacturing sector, “Medium industry” is defined as units with fixed capital of Tk. 10 to 30 crore excluding the value of land and building or with 100 to 250 workers. And “Small Industry” means an industry in which the value/replacement cost of durable

resources other than land and factory buildings is BDT 50 lac to BDT 10 crore taka or with 25 to 99 workers.

- In the non-manufacturing sector (trading and other services), —Medium Enterprises are those with fixed capital of Tk. 1 to 15 crore excluding the value of land and building or with 50 to 100 workers. And “Small Industry” means an industry in which the value/ replacement cost of durable resources other than land and factory buildings is 5 lac to 1 crore taka or with 10 to 25 workers.

Industry Types	Attributes	Trading/Service	Manufacturing
Small Industry	Fixed cost	BDT 5 lacs to 1 crore	BDT 50 lacs to 10 crore
	Number of Staffs	10-25	25-99
Medium Industry	Fixed cost	BDT 1 crore to 15 crore	BDT 10 crore to 30 crore
	Number of staffs	50-100	100-250

Table 3.1- Different types of enterprises in respect with fixed cost and number of staffs

3.2 GENERAL SME GUIDELINES BY Bangladesh Bank-

Bangladeshi SME sector is guided by general SME Guideline of Bangladesh Bank. Guidelines are as follows-

- Each bank/financial institution shall follow a separate business strategy in financing SME loan with least formalities in executing documentation to ensure easy and speedy loan sanction and disbursement process.
- Priority shall be given to small entrepreneurs.
- For small entrepreneurs credit limit will be ranged from Tk. 50,000 (Fifty thousand) to Tk. 50, 00,000 (Fifty lacs)
- For more participation of women entrepreneurs in industrial development of the country and for conducting business activities by women entrepreneurs in large number, priority shall have to be given to potential women entrepreneurs in respect of SME credit disbursement.
- Banks & Financial Institutions shall put highest priority in receiving loan application from small and medium women entrepreneurs and settle the loan disbursement process within very reasonable time from the date of acceptance of the application.
- Each bank and financial institution shall establish a separate 'Women Entrepreneurs' Dedicated Desk' with necessary and suitable manpower, provides them training on SME financing and suitably appoints a lady officer as chief of dedicated desk. Branch wise list of 'Women Entrepreneurs' Dedicated Desk 'should be sent to SME and Special Programs Department of Bangladesh Bank within two months from the date of declaration of this policy and program.
- Banks and financial institutions may sanction up to Tk. 25, 00,000 to women entrepreneurs against personal guarantee. In that case, group security/social security may be considered.

- The success in SME loan disbursement will be considered as yardstick for further approval of new branches of the concerned bank. License for New Branches will be issued for financing the priority sectors like SME and agriculture from 2010 in the name of ‘SME/Agriculture Branch’ instead of ‘SME Service Centre; in order to involve banks in financing priority sector like SME and Agriculture’.
- Each bank/financial institution shall fix the interest rate on SME loan sector/subsector wise. However, bank/financial institution will inform Bangladesh Bank sector/sub-sector wise rate of interest immediately and ensure disbursement of refinanced fund to the clients (women entrepreneurs) at Bank rate +5% interests.
- Training programs shall be arranged for the entrepreneurs

3.3 MINIMUM REQUIREMENT FOR SME FINANCING ACCORDING TO BANGLADESH BANK-

Each and every SME provider is regulated by separate restriction given by Bangladesh bank along with general banking rules. It may be noted that those minimum requirement should not in any way interrupt the role of monument process through establishing comprehensive credit risk management system appropriate to their type, scope, sophistication and scale of operation. The Board of Directors of particular bank is required to establish policies, procedures and practice in order to define risks, specify security requirement, design internal control and ensure strict compliance with them.

All the minimum requirements can be described as follows-

- 1. Pre-operation**
- 2. Operations**
- 3. Discloser/ethics**

3.3.1 Pre-operation-

Before undertake small enterprise financing, bank/financial institutions are required to follow some specific guidelines. Firms that have already established SME financing are required to compliance with the guidelines by six month of the date of issuance of Small Enterprise Financing Prudential Regulations. Pre-opertion guidelines are-

- a) For the purpose of undertaken SME financing, banks are required to set up own separate risk management capacity which will be properly staffed in combined with sufficient expertise and experienced person in the field o consumer finance/business.
- b) The bank shall develops comprehensive credit policies suitably approved by Board of Directors. The policy will cover loan administration combined with documentations process, disbursement systems and appropriate monitoring mechanism. The policy will also revise with job description and job specification of different layer staffs. Along with it, policy shall specify powers/authority relating to approval/sanction of consumer finance facility.
- c) The bank shall develop specific Product Program Guide (PPG) for every type of SME activities. The program shall describe the eligibility of the borrower in terms of objectives or quantitative parameters. It shall also determine the maximum permissible loan limit of each borrower. Along with that, PPG shall indicate the maximum permissible exposure banks will take against each product.
- d) The SME undertaking bank shall have computer based Management Information's System (MIS) which will cater the need of small and medium enterprise financing portfolio and should be flexible enough to generate necessary information regarding various clients and their payments behaviors. This periodical report are expected to help in generating new policies, effectively implementation of current policies and facilities appropriate modifications of existing policy.

- e) The bank shall prepare product wise profit and loss account quarterly which will adjusted with the provision on account of classified account as expected. The profit and loss account should be present to the Board of Directors in the immediate next board meeting. In case of foreign banks, the report should be place before committee combined with Chief Executive Officer, Chief Financial Officer and Head of Small enterprise.
- f) The bank shall have comprehensive recovery procedures for the delinquent loan. There must have a constructive procedure to recover loan defaulters. That recovery procedure my very product to product, but the distinct should be prescribed in such manner so that pre-planned enforcement measures could be taken immediately.
- g) All the institutions starting/undertaken small and medium enterprise financing are instructed to gone through some training on an ongoing basis to their capabilities related with various aspects of SMEs. The bank shall prepare standardized set of borrowing and recourse documents for each types of SME financing.

3.3.2 Operations:

- a) Like other financing institutions, small and medium enterprise financing institutions are subject to set up own credit risk management process. The process includes- information about borrower past dealing with banks, assessing the clients ability to repayment, sources of repayment, net worth and information obtained from Credit Information Bureau approved by Bangladesh Bank.
- b) While granting loan to the borrowers, bank shall obtain written declaration from the borrower reviling the details of various facilities he/she already obtained from other financial institutions. The bank shall carefully gone through the declaration detail and find out whether the customer exceeds the resemble limits as laid down in the approved

policies of the banks. Additionally this declaration helps the bank to avoid exposure against an enterprise having multiple facilities from different financial institutions.

- c) Bank should establish its own internal audit and control system in order to review its activities. For its inheriting nature, SME portfolios are subject to high risk and various weaknesses. The internal audit review managerial decisions in order to rectify the weaknesses of SME financing and reduce the level of risk. Another function of the internal audit is to look after the delinquency of internal control. It also figured out whether standardized policies are developed and practiced in reality.
- d) The bank shall ensure that their accounting and computer systems are properly equipped so that bank can avoid mark up. Even if it marked –up, bank must ensured that the marked-up charge on the outstanding amount is kept separate from the principal. The banks shall also ensure that any repayment made by the borrower is accounted for before applying mark-up on the outstanding amount.

3.3.3 Discloser/ethics

Bank shell disclose all necessary terms and conditions regarding fees-charges; interest rate and penalties. It should also reveal internal information to some extend because sometimes it contains conditions related with interest rate and pre-payments penalties. In order to make it hassle free and keep update with clients, banks are encourage to published brochures regarding their different mood of products, eligibility to apply and frequent asked questions.

3.4 SME SITUATION AT A GLANCE-

Bangladesh is mainly an agrarian based country. The economy of Bangladesh has undergone rapid structural transformation towards manufacturing and services. The contribution of the agriculture sector to GDP has declined from 50 percent in 1972-73 to around 20 percent in 1999-2000 and 15 percent in 2004-2005 (Bangladesh Bureau of Statistics Bangladesh Bank websites). The growth of industrial production has achieved more than 6% over the last 5 years. In the industrial sector, the Small and Medium Enterprise (SME) is widely believed to be the potential engine of economic growth of Bangladesh. According to the 2003 *National Private Sector Survey of Enterprises in Bangladesh* says that the SME sector accounts for-

- Around 40 percent of gross manufacturing output,
- 80 percent of industrial employment,
- 25 percent of the Total Labor Force in this economy,

The survey estimated that micro, small, and medium enterprises contributed around 20– 25 percent of GDP. Additionally this sector was found to encompass about 79,754 establishments, of which 93.6 percent were small and 6.4 percent medium (ADB, 2004).

Currently in Bangladesh four public banks, six private limited banks, few specialized banks, and several financial/non financial firms and to some extent NGOs are providing SME loan. According to “*Major Economic Indicator: Monthly Update Status*” (as on 31st March, 2012), the SME portfolio of entire industry as follows-

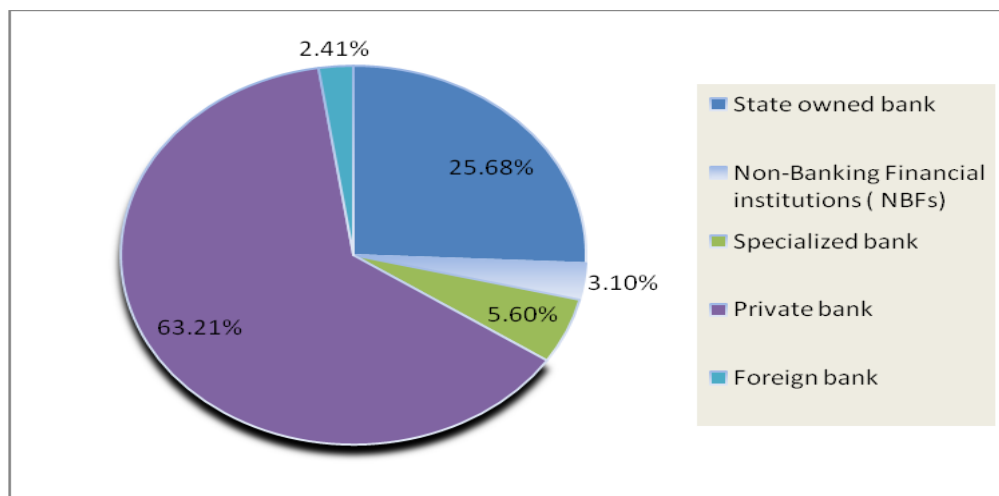


Chart: 3.1- SME providers in Bangladesh

3.5 IMPORTANCE OF SME IN BANGLADESH-

➤ **Employment generation-**

Developing country like Bangladesh where unemployment rate is near 17% (according to ADB), SME plays vital role to create employment. In 2006, 55% of jobs were created through SME. The *National Private-Sector Survey of Enterprises in Bangladesh, 2003* identified that in Bangladesh the agriculture, manufacturing and industry, and service sector could create most employment for the poor people.

➤ **Support small and medium enterprises-**

In Bangladesh, poor people are finance by micro-finance institutes while heavy businesses are encourage by corporate banks. Within this gap small and medium enterprise were ignorant by the traditional banking theme. However all those small and medium business are profitable. With the help of SME loan any potential borrowers can access BDT 2 lac – BDT 30 crore which were unthinkable even before 10 years back. BRAC bank provided 47.49% as SME loan of its entire loan amount in 2011.

➤ **Encourage manufacturing-**

Though Bangladesh is an agro-based country, for the time being entrepreneurs are more interested on manufacturing sectors. In the period of Jan-June 2012, BDT 10,463 billion has been invested in manufacturing sectors which is more than 2.3% of last year on the same period.

➤ **Enhance living standard-**

SME sector contributes in increasing living standard through- GDP growth, GNP growth, and employment generations, providing low priced local products, transecting local resource and improving rural life.

➤ **GDP growth-**

In 2011, SME resulted 25% GDP growth in Bangladesh. Through SME sector, Bangladeshi economy became able to decrease its dependency on foreign products, at the same time it has increased local resource transactions. SME's contribution to national exports is also significant.

➤ **Poverty reduction-**

Poverty reduction is the logical sequence of employment generation by SME. Sector wise progress has facilities poverty reduction in both urban and rural areas.

➤ **Women empowerment-**

There has been increased women's involvement in SMEs, especially home-based micro enterprises engaged in the production of clothing and textiles (boutiques and handicrafts, weaving and spinning), livestock and dairy, and retail sales.

➤ **Decreases of urban migration-**

In Bangladesh most of the heavy firm, renowned businesses have been set up around Dhaka city. So there is tendency to come into Capital in-search of job. However SME has given new ray of hope to the entrepreneur of rural areas. About 60-65% of SME's are located outside of metropolitan areas of Dhaka and Chittagong, having easy access to labor and less problematic business environment. Business cost in rural areas is low which also offer better prospects for industrial dispersal. Thus SME decreases urban migration.

➤ **Creation of entrepreneurs-**

According to Mr. Aftab (former SME Foundation Chief)- *"SMEs are labor-intensive and low-capital based. Thus it's encouraging individual entrepreneur to invest and to take risk."* Mainly they are encouraged to invest in manufacturing sector where general public appeal is high.

➤ **International business growth-**

“SME’s contribution exports is significant through different industries such as readymade garments, jute and leather” said by SME Foundation chief Mr. Aftab.

➤ **Innovation-**

There is evidence in the context of developing countries that innovations from small enterprises have led to greater benefits to large-scale businesses. One salient feature of SMEs is that they often rely on home-grown techniques of production, which are based on authentic innovation. Now if they can be protected under intellectual property rights, this may generate substantial business opportunities for SMEs.

3.6 SME FINANCING NEED:

Investment is essential for the growth of any industry and increased facilities in obtaining credits can enhance that growth. Finance is needed at the starting phase of a business as well as at the enduring phases. The entrepreneurs require mainly three types of finances, namely-

- ✓ Equity capital - to finance assets at the start of a business;
- ✓ Debts – to refinance assets;
- ✓ Working capital – to maintain the day-to-day activities

However, the access to financing is recognized as the leading obstacle to SME growth in Bangladesh, alike most other developing and under-developed countries. Productivity analysis indicates that smaller metropolitan firms are more productive than larger ones in many industries. This suggests that, with efficient factor markets, resources should be more appropriately redirected to assist these enterprises under suitable incentives. Yet, small entrepreneurs are poorly skilled and educated, mostly informal, and most importantly, they have

limited access to finance which has been identified as core of the major impediment in SME sector development.

3.7 SUPPLY-DEMAND ANALYSIS FOR SME CREDIT:

The overall supply–demand gap for SME credit is estimated at Tk165 billion. While 75% of non-metropolitan firms report a need for financing, only 6% of nonmetropolitan enterprises availed of formal finance. In the past 3 years, 3% had borrowed from banks and 3% from nongovernment organizations (NGOs) and/or MFIs. Access to formal finance for larger nonmetropolitan enterprises (employing 10 or more workers) is comparable to that of smaller metropolitan firms, with 32% reporting having a bank loan and 3% with NGO and/or MFI loans.

3.7.1 OVERALL SME CREDIT DEMAND ANALYSIS

The market size for loans to SMEs is estimated to be nearly Tk255 billion, with 226,000 potential clients. This estimate has been drawn based on the following calculations:

- ✓ An estimated 5.9 million micro, small, and medium-sized enterprises in 2003. This based on population growth; suggests 6.8 million such businesses in 2006.
- ✓ Only 2.5 million of the 6.8 million enterprises are estimated to have annual profits above Tk50, 000.
- ✓ 84% of enterprises want to borrow. Of these, only about half will be both willing and able to borrow at a given time (based on the assumption that 70% of firms that want to borrow are creditworthy and that 70% of these are borrowing at the same time). This means that 1 million micro, small, and medium-sized enterprises are potential borrowers.
- ✓ About 78% of these enterprises are micro, 17% small, and 5% medium-sized

- ✓ The potential lending volume for each segment is calculated by multiplying the number of enterprises in that segment by the average loan for that segment. Average loans are determined Tk50,000–Tk300,000 for microenterprises; Tk300,000– Tk1,000,000 for small enterprises; and TK Tk1 million–Tk5 million for medium-sized enterprises.

Segment	Share of total (%)	Number of enterprises	average loan size (Tk.)	Lending volume (in billions)	Market share (%)
Micro	78	805,477	175,000	140	35
Small	17	179,366	650,000	117	30
Medium sized	5	46,420	3,000,000	138	35
Total	100	1,031,263	38,25,000	395	100

Table 3.2: Estimated Credit Demand for Bangladesh’s SME

3.7.2 OVERALL SME CREDIT SUPPLY ANALYSIS

As on March, 2012, six private banks have 63.21% of the market share for SME lending nationwide, which equals a total of TK 27.50 billion. The remaining four public banks and financial institutions including specialized types of banks hold an estimated 12% market share (6% each) for SME lending. This suggests an estimated total current supply of SME credit (SME loan principal outstanding) of Tk32.55 billion in the first half of the 2012 where in 2011 the figure was BDT 26.143 billion. That means SME loan has been increased by 24% (The daily Protham Alo, 30th August 2012).

Bank type	Principal outstanding (TK in billions)
Private banks	27.50670
Public banks	1.91468
specialized banks	1.77967
Total SME lending volume (principal outstanding)	32.255
Yearly target achieved (%)	55%

Table 3.3: SME Loan Outstanding (TK in Billion)

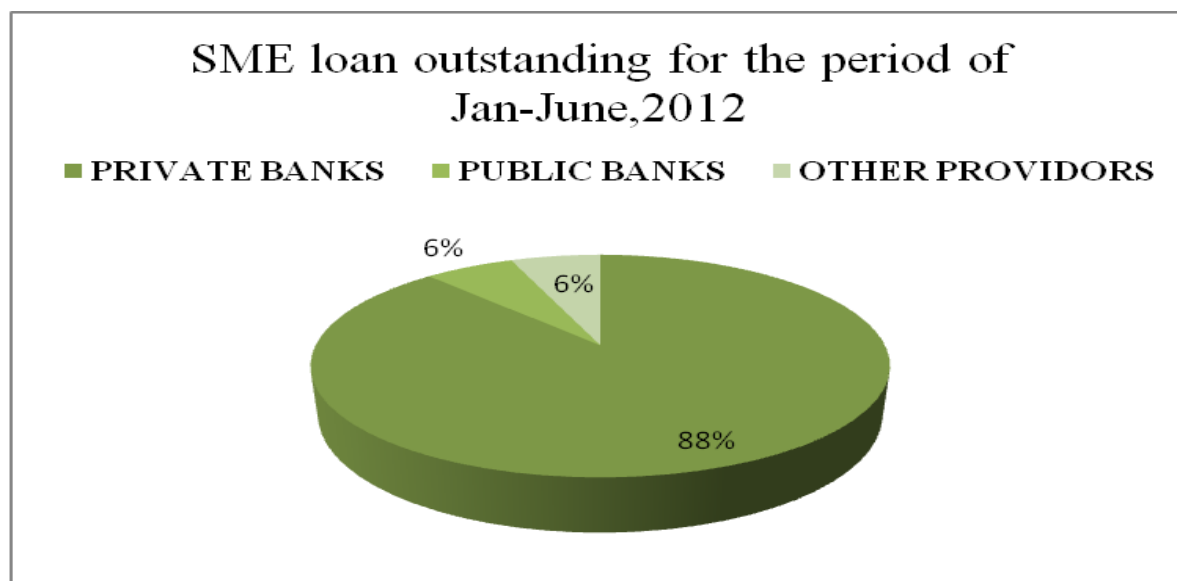


Chart 3.2 - Graphical presentation of SME loan outstanding in 2012

3.8 WHY BANKS' ARE NOT INTERESTED IN SME FINANCING?

Currently in Bangladesh 54 banks are operating (including nationalized, private, foreign and specialized banks). Unfortunately only few of them have come forward to provide SME financing. Bank's conventional job is to gather unused money from people and lend it to the borrower at a higher interest rate. On the other hand SMEs is far different from that conventional

banking process. Basically high risk in SME financing and lack of experience are two major cause that discourage banks to invest in small and medium enterprises. There are some other reasons preventing banks to initiate SME financing. Those causes are described bellow-

- **High risk-**

Since SME finance are given to the small and medium entrepreneurs, there are high risk associated with it. This risk is related with recovery amount, repayment behavior, defaulters' rate ETC. Recently a report published in the *Daily Star*, 25th June, 2012, showed that BRAC Bank has the highest number of loan defaulters (29,203 in person) which is the prior SME based bank. Study also showed that BRAC Banks' Portfolio At Risk (PAR) is 22-23 % which supposed to be 0-5%.

- **Repayment rate-**

Repayment of the manufacturing sector is not satisfactory. In SME financing credit recovery rate is low comparatively other financing. Bankers found manufacturing SMEs weak in managing business; from planning to purchasing, design, production, quality control, marketing, finance, human resources, public relations, new business developments and target growth.

- **Industrial structure of SME-**

SME provides loan to small and medium industries fisheries, light machinery bakery ETC. Those types of industry are not in a booming situation. Investor's bankers are interested in financing at telecommunications, fertilizers, and pharmaceuticals companies and cement factories which have a vivid and rapid growth. On the other hand small and medium industries are not clearly vibrated. Also industry structure is not constructive.

- **Low profit margin-**

Generally the loan size under SME financing is comparatively small than corporate loan. At the same time the repayment period is low which results more opportunity cost of the banks. All those things make low profit margin to the bank.

- **Unsecured loan-**

To encourage small and medium entrepreneurs, SME loan requires zero/minimum mortgage and collateral securities. Though it is good for borrowers, lenders hardly benefited by it. When there is no/low mortgage is kept, it increases lenders risk to be loser.

- **Regulation from Bangladesh Bank-**

Bangladesh Bank has set up several policies to regulate SME financing. It has been done due to prevent misuse of SME. However to some extends it hampers lenders' interest.

- **Lack of experience-**

Bangladeshi banking sector is not that much experienced in SME yet. Still few banks are dealing with SME financing. There is lack of necessary information while SME has a great contribution in economy. Lack of experience hinders new financial institutions to launch SME Service.

3.9 CONSTRAINS OF SME-

Bangladeshi trade and banking sectors are regulated by several policies which on the other hand hinder SMEs activities. Due to regulate private investment, Bangladesh government and Bangladesh bank have established several policies like investment sanctioning, trade policy, fiscal policy, credit disbursement, import licensing, legal and administrative policy, foreign exchange allocation etc. Undoubtedly all those policies have an adverse impact on SME growth of the country. Since SME sector itself weak structured sector, further pro-active steps are required for the growth of it. All the constrains can be categories as follows-

1. Policy level constrains
 - a. Trade Policy

- b. Fiscal Policy
- 2. Legal, Regulatory, and Administrative Constraints
- 3. Financial Constraints
- 4. Major Industrial Constraints

All the constrain facing by SME sector are described bellow-

3.9.1 Policy level constrains-

It has been mentioned earlier that several policy have been developed for the betterment of the economy, sometimes those policies create obstacles into the path of SMEs growth. Trade policy and fiscal policy are two most significant policies which affect SME sector.

a) Trade policy-

In last few decades, Bangladesh experienced significant trade development from the both export and import sectors. With the modern business arena readymade garments, fisheries, leather, jute ETC sectors have flourished tremendously. In order to compete in world market, the import procedure has been greatly eased; Import tariffs have been lowered and quantitative restrictions have been eliminated. Thus, import of raw material/semi goods for further production has been greatly benefited. However this liberalization also exposed the domestic product to compete with foreign products. One way its preventing domestic industries to flourish, other ways it hinder local product to get explore in international stage. Following policies need immediate concentration in order to encourage SME sector-

i) Prior Announcement of Policy Changes-

Sometime policy need to be change according to the situation. However there is problem regarding the announcement. Sometimes government declared new policy/change policy without any prior notice. It harms most when new policy

adopted regarding tariff change. Since producers are not prepared, they filed to measure the degree of competition that they are going to face.

ii) **Tariff rationalities and valuation-**

In Bangladesh there is little gap between raw material and finished goods. As a result entrepreneurs are more encourage buying finished goods then raw materials. It hinders domestic productions. Also lower the duty rates on finished goods. A significant gap between raw material and finished goods can be made through counting possible under-invoice cost and dumping cost on finished goods.

b) **Fiscal Policy-**

Different fiscal policies are obtained in order to increase government income and discourage some purchase to some extent. Fiscal policy includes Value added Tax (VAT), wealth Tax, Tax Holiday ETC.

i) **Value Added Tax-**

Like other large business organization, SME's products require to given certain per cent as value added tax. All the manufacturing or productive firms have to pay 2.5% turnover tax (not exceed to 1.5 billion). However with the lieu of 15% VAT, it's paying like large firm. Also different supplementary tax rate are imposed on certain types of consumption goods. Moreover there is an exercise of different excess duty on limited number of item. In word, all the SMEs and large scale firms are paying moral less same taxes which supposed to be different.

ii) **Tax Holiday-**

In Bangladesh SMEs is not treated specially in terms of duty on capital machinery and direct taxes. There are provisions of tax holidays for enterprises of all size categories subject to rules and procedures set by the National Board of Revenue. In order to get this tax holidays, enterprises are required to get approval from National Board of Revenue. Unfortunately it's a lengthy process. Most importantly, sole

proprietorship form of business is not allowed to enjoy facility which is the usual form of small and cottage industry.

iii) **Wealth tax-**

Wealth tax is paid by the individual if his/her net wealth exceeds certain amount. In Bangladesh minimum amount of wealth tax is 15%. Our existing law does not encourage large company to pay wealth tax which generates huge profit in year. On the other hand, most of the small industry is organized by sole proprietorship. Hence it become subject to the wealth tax on their business capital. Thus, this fiscal policy hindering SMEs growth in Bangladesh.

3.9.2 Legal, Regulatory, and Administrative Constraints-

In the last few decade policy reforms have brought about substantial relaxation in the investment sanctioning procedure. Own financing does not require prior approval anymore. However, following procedures hindering SMEs growth-

a) **Trade License-**

Any kind of business needs trade license to prove its validity. It also shows that particular business has necessary permission to run its activities. Trade license is given by City Corporation or Union Prorishad (or any governmental bodies) against statutory fees. However this whole process combined with harassment, dilutions, and bribes.

b) **Registration under Factories Act-**

According to the Factories Act 1965, all manufacturing units employing 10 or more workers are required to be registered with the office of the Chief Inspector of Factories and Establishments. The job of the Factory Inspector is to oversee the working condition and safety measures in the factory. However, this requirement become painful to the entrepreneurs specially to small and medium entrepreneurs because the existing

regulations do not differentiate between different size categories with respect to safety and working conditions requirements of SMEs. Thus those regulations become a source of harassment, side paying and illegal activities.

c) Clearance from the Department of Environment-

In order to protect environment, all industries are also required to obtain a certificate from the Department of Environment. It stated that particular business has proper arrangement for anti-pollution and safety measures. Here once again, the requirements do not clarify the type and size categories of industry. In results, harassment, corruption and un-official payments are made by it.

d) Registration with Sponsoring Agency-

To keep track of private investment in various sub-sectors, it would be useful to make registration with the sponsoring agency is mandatory. Bangladesh Small and Cottage Industries Corporation (BSCIC), Board of Investment (BOI) or Bangladesh Export Processing Zone Authority (BEPZA) ETC is example of sponsoring agencies. However whether the entrepreneur wants to avail themselves to the government incentives or not, it totally depend on the entrepreneurs. In first stage, small entrepreneurs' face lack of information to registered with sponsoring agencies. Even if they came to known it; get registered and avail facilities are another hassle full steps. Unless or until that procedure have not simplified, small and medium entrepreneurs will feel discourage to go through it.

e) Contract Enforcement and Resolution-

In Bangladesh contract enforcement system and resolution system is not adequate enough to solve related problems. Those problems arise from archaic legal system where procedure of adjudication is lengthy and awkward. Also the whole system is corrupted.

3.9.3 Financial Constraints

a) Access to Finance-

The SMEs face financial crisis while they undertake loan from financial institutions. Banks are reluctant to provide SME loan due to high processing and monitoring cost. In past few years several attempts have been taken to gear up SME sector. For example- Bangladesh Government instructed to keep at least 5% of bank's loan portfolio for small and cottage industries. New specialized form of bank named Bank of Small and Cottage Industries (BASIC) was set up in 1988 with the objective of financing the small and cottage industries. There were provisions of favorable debt equity ratio, special interest rates and credit guarantee scheme. However all the steps proven inadequate in the path of SMEs growth. Still the investor banks have little incentives while giving SME loan. The loan application forms for investment financing from banks are long, tiresome, and outmoded. Also SMEs find it difficult to use non real estate assets as collateral to obtain loans from the banks.

b) Project Preparation and Evaluation-

The SME financing procedure is lengthy and clumsy in nature. When it comes to borrower the process become more painful. The borrowers face problem at the very first stage of project preparing and submitting. Instead of standardized loan procedures prescribed by Bangladesh Bank, bank and financial institutions are more comfort with their own developed loan procedures. The entrepreneurs hardly have sufficient knowledge to formulate project proposal. Even if the entrepreneur become able to make it any way, there is no guaranty that the proposal will properly evaluated since the SME service providers are lacking with expertise of project evolution.

c) Collateral Requirements-

Collateral requirement is one of the vital problems which hindering bank to lend SME financing. Traditionally banks are more encourage to mortgage land or that type of asset so that risk level reduced. However that made SME financing literally in treble. As most

of the small and medium enterprises have no/little land or fixed asset to keep as mortgage and manage loan. If the SME providers feel to arrange more and more deposit relationship with the owner and keep track with the cash flow of the business as credit-worthiness, it would help both the parties more.

d) Bureaucracy and Corruption-

In Bangladesh all types of bureaucratic activities are victim of corruptions, inflexibility, inefficiency and political interventions. No single work is done without possible hassles and side payments to some extent. Borrowers specially SME borrowers face negative attitude from the responsible persons of the bank because either lender wants to avoid financing in risky SME sector or bound the borrower to pay un-official payments in case of loan processing. Unless or until there are any major reformation of that hassle full process, the borrowers will keep burning in this bureaucratic malice.

3.9.4 Major Industrial Constraints-

Several studies have been prepared in order to find industrial constrains encountered by small and medium industry. Combined results are given bellow-

1. Country's economy as whole facing serous utility crisis problem. Insufficient supply of gas, water, electricity and fertilizer result low production. SME sector is suffered by it most.
2. SME sector is not supported enough by government. Government's few incentives for SME and improper practice of those policies prove that still SME is not counted as foremost progressive sector in Bangladesh.
3. Unavailability and/or high price of raw materials, huge production cost, poor quality labor force, industry wise incentives, and low demand of SME based product in abroad est. are hindering SME growth.

4.1 SME BACKGROUAND OF BRAC BANK-

BRAC Bank is a financial hypermarket that offers financial solutions for all strata – be it retail, SME, wholesale banking, capital market, or remittance; but it always had a focus on SME. This bank was actually founded on a philosophy of keeping trust on the hopes and dreams of Bangladeshi entrepreneurs – and majority of these entrepreneurs have been beyond the conventional banking reach.

If we think of the financial pyramid, there are corporate institutions (local and multinational) at the top of the pyramid and there are low income individuals at the bottom. Those at the top are served by banks and other financial institutions while those at the bottom are served by Micro Finance Institutions (MFIs), e.g. NGOs. But SME sector in the middle were missing access to necessary banking services and that's where BRAC Bank has filled the gap. The corporate mission of BRAC Bank Ltd is to ensure —sustained growth in SME sector. In parallel with this goal, SME sector, the main concentrated area of the bank financing since its inception, comprises of more than 50% of total loans and advances.

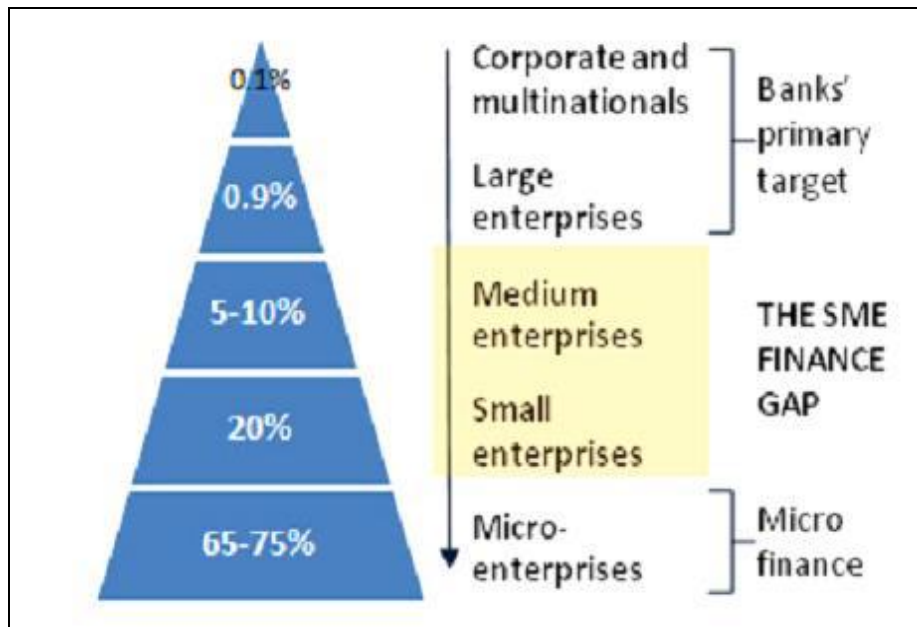


Figure 4.1: The SME Financing Gap

4.2 SME BANKING DIVISION-

BRAC Bank Limited is the largest SME Bank in the country and 4th largest SME Bank in the world in terms of outstanding loan amount. SME Banking Division holds highest asset volume among the business divisions of the Bank (SME Banking, Retail Banking, Corporate Banking, and Probashi Banking). As the name signifies, it provides lending and deposit solutions as well as value adding services (payment remainder, payment notification, etc) to small and medium size businesses within the country.

According to “*Major Economic Indicators, Monthly Update Status*” as on 31st March, 2012-

- The division has captured 5.28% market share within SME Banking arena of Bangladesh which valued 8.35% within the private banking industries.
- It has served 320,000 entrepreneurs, with BDT 144,330 million of SME loan through 503 customer touch points (399 SME Unit Offices, 51 SME Sales and Service Centers, Krishi Branches, and Branches).
-

Target Market:

Restaurant, Light machinery, Large tailoring business, Weaving mills, Bakery, Printing house, Feed mill Poultry, Dairy firm, Fisheries, Manual/auto rice mill, Boutiques and parlors, Imported foods (biscuits, cheese, juice, and such items), Distributor of FMCG products/others, Building materials (rod, cement, brick, paint, and others), Food grain wholesaler, Wood processing/saw mills, Tight engineering, Handcraft, Electrical and electronic items, Trading of grocery item, Hardware, Chemical products, Sanitary ware, Fish wholesaler ETC are the target market of BRAC Bank SME division.

SME PRODUCTS-

BRAC Bank, being the youngest bank, took a step to break away from usual tradition and tapped into the true suburb entrepreneurial initiatives.

Currently BRAC Bank has following SME loan products –

Product name	Eligibility	loan amount	mortgage	Business type	Overdraft facilities	Special features
ANONNO (Business Loan)	Small sized businesses (Production, Trading, Service, Agro based products and others) Having at least 3 years business history	BDT 3 Lac to 10 Lac.	no	Sole proprietorship, Partnership or Private Limited company		No security required
APURBO (Term loan)	Any kind of business operating at least 3 or more years	BDT 1 million to BDT 10 million	property/land /building		Based on business needs	
PROTHOMA (Term loan)	small scaled business operated by women entrepreneur having 2 or more years business experience	Maximum BDT 1 million	no	Sole proprietorship, Partnership or Private Limited Company		Low interest for woman entrepreneurs
SHOKTI (Business Loan)	Any kind of business Having At least 1 year bank statement.	BDT 1 million to BDT 10 million			yes	Loan against partial security or fixed deposit
DURJOY (Business Loan)	Any kind of business having valid trade license, which has been operating for at least 3 years. Need 1 year bank statement	BDT 3 Lac to BDT 2.5 million	no	Sole proprietorship, Partnership or Private Limited Company.		Easy instalment up to 5 years.

Table 4.1- comparative analysis of BRAC Bank SME products

Apart from it, there is SHOMRIDDHI SME Loan to meet import-export related expenses, post import expenses, tax/duty payment, local bill purchase and working capital. SHOMRIDDHI loan is offering BDT 1 Lac to BDT 20 million to any kinds of Sole proprietorship, Partnership or Private Limited Company having valid trade license and which has been operating for at least 3 years. It provides- 1) LC and LATR facility. 2) Revolving loan, overdraft and 3) Local bill discounting facility for exporter/importers.

Presence of SME-

Small Business department of the division works through 399 unit offices all throughout the 64 districts of the country. The department is divided into three regions named – Dhaka, Khulna and Rajshahi. Each region comprises of 6 to 7 territories. Territories are divided into zones and zones are further divided into unit offices. Currently there are 24 territories and 120 zones. Medium Business department is currently located in Dhaka and Chittagong city to look after the mid size borrowers of SME Banking arena.

SME Network Coverage



4.3 SWOT ANALYSIS OF BRAC BANK LTD'S SME FINANCING:

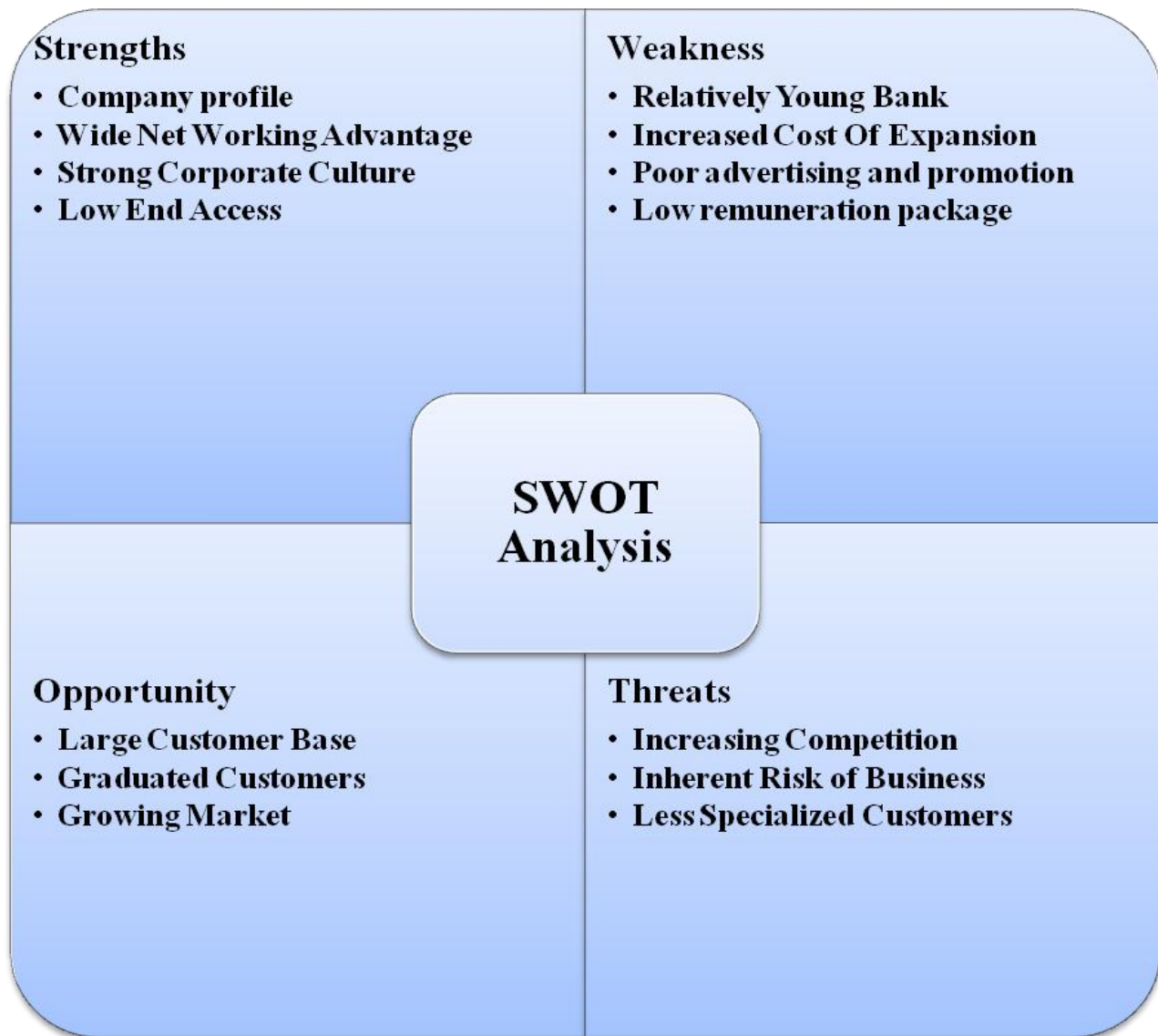


Figure: 4.2 SWOT Analysis of BRAC Bank Ltd's SME Division

Strengths-

- Company profile- BRAC bank enjoys the reputation of mother organization BRAC. Since BRAC has already established its own reputation in home and abroad, it becomes a competitive advantage for BRAC bank. At the same time BRAC bank created its own brand image itself within six years of establishment.
- Wide Net Working Advantage: BRAC Bank Ltd. enjoys an existing establishment of nationwide network from its parent organization BRAC (NGO). They can receive manpower and/or infrastructure from the parent organization.
- Strong Corporate Culture: BRAC Bank Ltd upholds a corporate culture that operates under a double-bottom line agenda where profit and social responsibility go hand in hand. This attitude of the bank makes them more compatible with SME operations.
- Low End Access: BRAC Bank Ltd has an advantage of access to low end clients like farmers because of the Micro financing activities of BRAC NGO. So when they will go for full fledged agricultural financing for SME they will have greater reach of their clients.

Weakness-

- Relatively Young Bank: BRAC Bank Ltd is a relatively new bank commencing its SME operations in 2001. This may amount to a lack of experience weakness.
- Increased Cost Of Expansion: BRAC Bank Ltd has 421 SME units including 46 SME sales and service centers which is more than any other bank's SME activity. With this fast growth in an inbuilt risky sector, they have to incur increasing cost.
- Poor advertising and promotion of SME loan: Where other subsidiaries get well promotional activities, unfortunately SME does not. Any new product launching is not covered thoroughly by media. Bank has minimum signboards at some point of the country. As a result people are not aware of the existing products and services.
- Low remuneration package- This largest bank having huge profit has a low remuneration package for the low and mid level employees. The compensation package for BRAC bank entry-level positions is even lower than the contemporary banks. Under the existing

low payment structure, it will be very difficult to attract and retain higher educated employees in BRAC bank specially CROs.

Opportunity-

- Large Customer Base: BRAC Bank Ltd has an existing large customer base which gives them a clear head start against their competitors.
- Graduated Customers: BRAC Bank Ltd's early customers i.e. customers of Business Equity Loan and —Apurbo have now upgraded in their business. These customers make strong impact in their SME sector with new businesses or enter corporate sector.
- Growing Market: The SME sector in Bangladesh is still growing and the Government of Bangladesh is focusing strongly on this sector. This ample market growth opening is a big opportunity for BRAC Bank Ltd.

Threats-

- Increasing Competition from Banks, MFIs: With Bangladesh Government's robust encouragement towards SME financing more and more banks and MFIs are increasing their SME activities.
- Inherent Risk of Business: The SME consists 60% of BRAC Bank Ltd's activity where other Bank and financial institutions generally prefer large enterprise clients because of lower transition costs, and greater availability of collateral.
- Less Specialized Customers: The clients of SME loans are mostly people with no previous banking experience. They do not keep records of their business properly so cannot provide adequate data which increases the risks associated.

4.4 SME LOAN PROCEDURE of BRAC BANK

BRAC Bank Ltd. was set up with the growing need for capital mobilization and the need for formal contracts for a wider spectrum of clients of the country. When it came to SME financing, instead of approaching the problem by scaling down its regular operations, a separate program designed especially for SME financing was launched by BRAC Bank in 2002. BRAC Bank's effort is noted in this regard for its complete focus on the credit needs of the small and medium enterprises. Since the initiation of SME operations by BRAC Bank, it has become the Bank's largest and most profitable venture.

The unique feature of BRAC Bank is that it is the only bank that approaches prospective clients, while other banks wait for them to apply for loans when required. SME units of BRAC Bank are located in all districts of the country. Each unit has two to five Customer Relations Officers (CROs). The role of CROs is instrumental in not only selecting and approaching clients, but also in maintaining regular interaction with each client, monitoring the use of the loan and ensuring regular repayment.

Customer Relations Officer (CRO) helps a customer choose the scheme which best meets his financial requirements and fits his business size and nature. The CRO then collects all the requisite documents from the customer, consolidates the information, and after ensuring that all the required documentation are in place, he prepares the Loan Application Proposal (LAP) and passes it on to his Zonal Manager. The Zonal Manager visits the business, gives the file a final check and forwards it to the Credit Risk Management department of our bank.

The in the SME Credit wing visits the business location and analyzes the loan proposal by making an assessment of the customer's ability to repay based on his business profile and matching customer's proposal with his credit assessment to determine whether the customer can be financed. In areas where there is no centralized credit assessment department, the bank has audit team that visits the business location and assesses the file. The Origination department verifies the documentation and opens the loan accounts of our customers. In addition, they help obtain the CIB report of the customer, a mandatory requirement of Bangladesh Bank. The loan is then disbursed to the customer. SME Business and CRM jointly manage the collection responsibility across the country based on overdue aging. SME Repayment Unit performs the functions of loan repayment and the Closing Unit does the loan closure.

The CRO obtains the deposit slip from the customers for the monthly installments; he sends a mobile text to Head Office for realization of the installment. The slips are collected at the repayment unit for reconciliation. As the loan matures, the closing and clearing units handle the necessary paperwork and forward the clearance certificate and redemption authority of mortgage property to the respective CRO/ZM, who then hand them over to our customer.

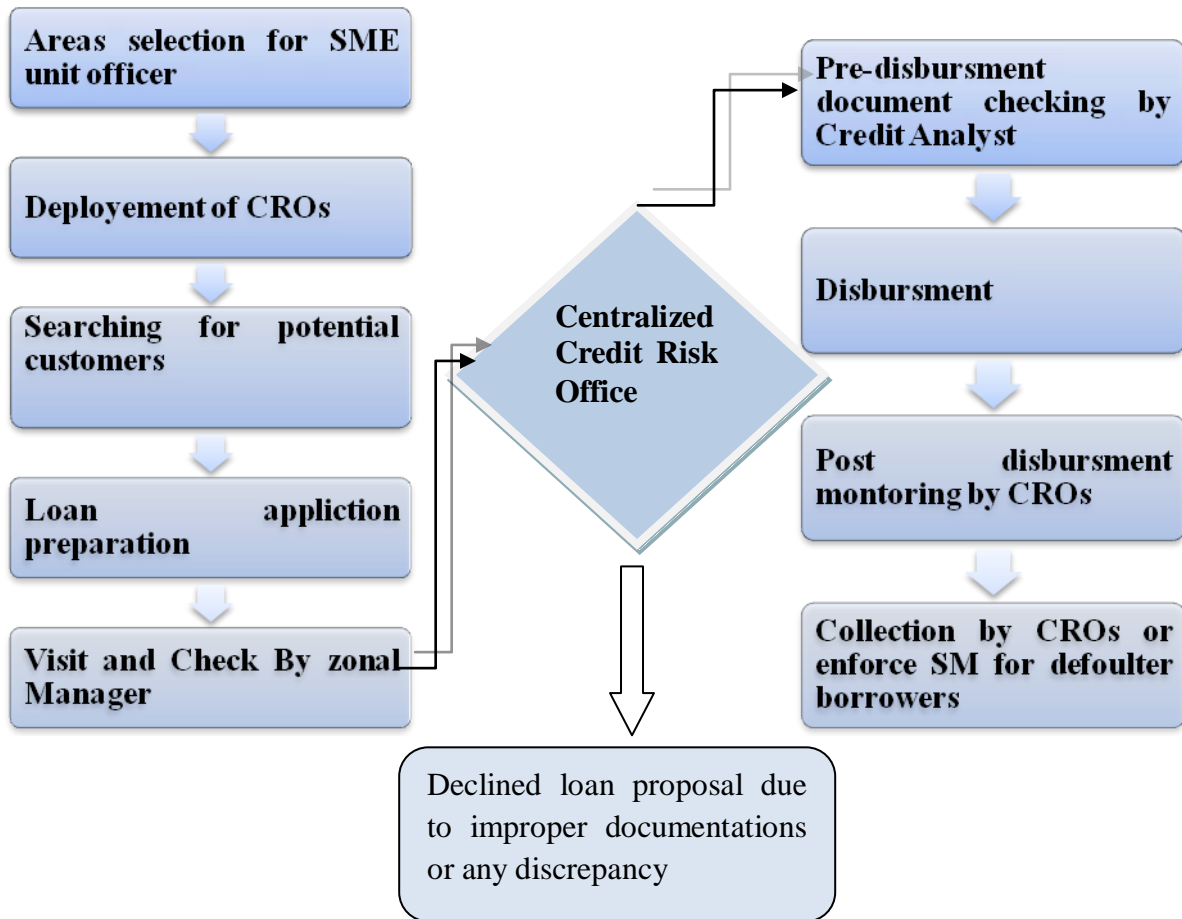


Figure 4.3- BRAC BANK loan Processing Flow

4.4.1 Enterprise Selection Criteria

The success of SME will largely depend on the selection of a business and man behind it. In terms of the business (Enterprise), the following attributes should be sought:

- The business must be in operation for at least one year.
- The business should be environment friendly, no narcotics or tobacco business.
- The business should be legally registered, i.e., valid trade license, income tax or VAT registration, wherever applicable.
- The business should be in legal trade, i.e.; smuggling will not be allowed or socially unacceptable business will not be entertained.
- The business must have a defined market with a clear potential growth.
- The business must be located ideally close to the market and the source of its raw materials/suppliers. It should have access to all the utilities, skilled manpower's that are required.

Any risk assessed by the management in turn will become a credit risk for the bank. So effort should make to understand the risk faced by the business.

4.4.2 Potential entrepreneur Selection Criteria

In order to understand the capability of the management behind the business, the following should be assessed:

- The entrepreneur should be physically able and in good health, preferably between the age of 25-50. If he/she is an elderly person closer to 50, it should be seen what the succession process will be and whether it is clearly defined or not.
- The entrepreneur must have the necessary technical skill to run the business, i.e. academic background or vocational training, relevant work experience in another institution or years of experience in this line of business.

- The entrepreneur must have an acceptable social standing in the community (People should speak highly of him), he should possess a high level of integrity (Does not cheat Anyone, generally helps people), and morally sound (Participates in community building)
- The entrepreneur must possess a high level of enthusiasm and should demonstrate that he is in control of his business (Confidently replies to all queries) and has the ability to take up new and fresh challenges to take the business forward.
- Suppliers or creditors should corroborate that he pays on time and is general in nature.

4.4.3 Guarantor Selection Criteria

Equally important is the selection of a guarantor. The same attribute applicable for an entrepreneur is applicable to a guarantor. In addition he should possess the followings:

- The guarantor must have the ability to repay the entire loan and is economically solvent (Check his net worth).
- The guarantor should be aware about all the aspects of SEDF loan and his responsibility.
- Govt. And semi-govt. Officials can be selected as a Guarantor such as school teacher, college teacher, doctor etc.
- Police, BDR and Army persons, political leaders and workers, and Imam of mosque cannot be selected as a guarantor.
- The guarantor should know the entrepreneur reasonably well and should preferably live in the same community.

4.5 COLLECTION AND REMEDIAL PROCEDURES OF BRAC Bank Ltd-

BRAC bank follows aggressive market strategy. This prominent SME financing institution has captured more than 5.28% share of entire SME industry. Due to its aggressive business practicing nature, it always remains in high risk. To BRAC bank maintaining minimum defaulter rate is the biggest challenge. For that reason it has to ensure proper loan collection and remedial process. The formal loan collection process as follows-

➤ **Receive SMS/Fax for installment deposits:**

When the borrower repays any installment of the loan then he/she informs it to the unit office/CRO. Then the unit office/CRO sends a SMS through mobile phone or a Fax to the loan administration division informing there payment .Loan administration divisions collect these SMS /Fax and take a paper print of these SMS.

➤ **Entry the installment information to MBS:**

Loan administration division gives entry of the repayment installment information to the banking software MBS.

➤ **Print Vouchers:**

Completing the entry, the loan administration division takes paper print of all voucher sin a prescribed yellow paper.

➤ **Cross Check SMS/Fax and solve problems (If Any):**

The loan administration is responsible for all entry in MBS. If there is any error found in future then the respective officer who is entering this information in MBS will be liable for it. It will be easily identified by user ID. So they always remain aware to ensure the correct entry. Completing the entry of information, they print a hard copy and crosscheck it with the SMS/Fax. If there any error found then it is solved and ensure the correct information entry.

➤ **Repayment voucher check and posting:**

If it confirmed that all entering information is correct and there is no error, then the responsible officer of the loan administration division posts it to MBS. If one time posted, it is not rectifiable without permission of the higher authority. So the loan administration is always aware regarding the recovery procedures of SME loan.

The above mentioned process describes very plain and formal loan collection procedures. However during monitoring if the CROs find any kind of irregularities with the borrower(s), they go through different steps. Several indicators help CROs to find out irregular loans.

Indicators and their interpretation from BRAC bank perspective-

Days Past Due (DPD) refers the number of days borrowers are not giving installment, counting from the following date of installment due date. Generally 2-3times irregular installments (or 30-20 days) can be accepted with 50% provision. In the mean time BRAC bank need to inform Bangladesh bank about that loan. If it becomes more than 3 consecutive installments, the borrower(s) become subject to 20% loan provision.

Portfolio at Risk (PAR) - When a loan account became delinquent for more than 30 days we can identify that account to be included as a risky account among the portfolio. The standard international measure of portfolio quality in banking is portfolio at risk (PAR) beyond a specified number of days:

$$\text{PAR (x days)} = \frac{\text{Outstanding principal balance of all loans past due more than x days}}{\text{Outstanding principal balance of all loans}}$$

The accepted range of PAR is 0-5%. However, currently BRAC Bank has 22-23% PAR.

Non Performing loan (NPL) - The amount of loan that is totally defaulter called non performing loan. Currently bank consists of 17-19% NPL.

After assessing the repayment portfolio quality, the zonal manager decides which loan how to recover. Here are two conditions-

If the DPD is within 1-179days, the CRO team collected the loan through connecting the borrower over phone calls; irregular and afterward regular physical visit to the borrowers.

By chance if the CROs team failed to collect the repayment within 180 days, the case is handled by Specialized Asset Management (SAM). This team is consists of expert deal with legal enforcement process. They could either bounce the cheque given by the borrower at the initial stage of loan application or in case of insufficient recovery they could file law suit at *Artho O Rin Adalat*. *Artho O Rin Adalat Act 2003* is one of the strongest acts in terms of recovering defaulter amount.

4.6 RISK MANAGEMENT PROCESS BRAC BANK-

BRAC bank has very constructive and well established risk management procedures in order to check credit risks. Credit risk refers the financial losses resulting from the failure of repayment by the client. When the clients failed to meet the legal obligation with the financial institutions called credit risk.

In order to mitigate credit risk, BRAC bank follows Corporate Credit Policy loan along with Bangladesh Bank Core Risk Management Guidelines. The credit policy explains general principles to oversee the detail lending procedures and risk measurement criterions of individual borrower to mitigate credit risk. The credit risk policy contains-a) Loan Originating; b) Credit Approval; c) Credit Administration;(d) Risk Management; and e) Monitoring, Collection and Recovery activities. In each and every single stage of SME loan lending, BRAC Bank tries to lower credit risk. There are some steps given bellow-

- Separate division for Corporate, SME and Retail has been formed which are entrusted with the duties of maintaining effective relationship with the customer, marketing of credit products, exploring new business opportunities etc.
- For transparency in the operations during the entire credit period- Credit Approval Committee, Loan Administration Department, Recovery Unit and Impaired Asset Management have been set up.
- The Asset Liability Committee (ALCO) of the bank monitors Balance Sheet risk and liquidity risks of the Bank. Asset liability Committee (ALCO) reviews country's overall economic position, Bank's Liquidity position, ALM Ratios, Interest Rate Risk, Capital Adequacy, Deposit Advance Growth, Cost of Deposit & yield on Advance, F.E. Gap, Market Interest Rate, Loan loss provision adequacy and deposit-lending pricing strategy.
- Strict internal control system allows BRAC bank to mitigate credit risk. Management through Risk Management Department controls operational procedure of the bank. Internal Audit & Inspection team under Risk Management undertakes periodical and special audit of the branches, SME Unit Offices and Departments at Head Office for review of the operation and compliance of statutory requirement.
- BRAC Bank has risk grading system according to which every borrower is judge. Even in case of every single account opening, BSSOs grade client's risk based on trisection profile. The risk assessment included borrower risk analysis, financial analysis, industry analysis, and historical performance of the customer.
- The whole credit application and proved process are done by expert credit risk management team. Every loan is approved by centralized credit tem. The whole application process is designed in such way so that credit risk could be mitigating to check the borrower several times. Loan Administration Department ensures compliance

with all legal formalities, completion of all documentation security of the proposed credit facility and finally disburses the amount.

- In case of credit approval system, BRAC Bank also focuses on social and environmental risk factor which could be resulted from SME lending decision taken by BRAC Bank.
- Since most of the profit comes from SME sector, for the future prospect, bank is now focusing in on assts portfolio quality. Currently BRAC Bank has asset portfolio of BDT 49,302 million.
- Changes in market liquidity and or interest rate exposes Bank's business to the risk of loss, which may, in extreme cases, threaten the survival of the institution. As such emphasize has given so that the level of balance sheet risks are effectively managed, appropriate policies and procedures are established to control and limit these risks and proper resources are available for evaluating and controlling these risks.
- There is a distributed collection model that consistently follows up with the borrowers for the timely repayments. There is also Monitoring team responsible for frequent visit over the borrower to ensure whether the enterprise invested the sanctioned amount in the pre-specified area of his business, how well the business is running, the attitude of the entrepreneur, cash credit sales and purchase, inventory position, work in process and finished goods so forth.
- In addition to the Internal Audit & Inspection team the Monitoring team conducts surprise inspection at the Branch, SME Unit and the Departments at Head Office as well. The Board Audit Committee reviews the reports of the Risk Management Department periodically.

- A special wing named “Special Asset Management (SAM)” deals with nonperforming assets through amicable settlement, execution of decrees and arrangements of auctions to sell the mortgaged properties. SAM is also engaged to monitor Early Alert Accounts. At BBL, we are very keen to identify, measure, monitor and control credit risk and ensure that adequate capital against these risks are maintained, at the same time they are satisfactorily compensated against the risk of potential losses.

- The overall organization structure also helps to mitigate credit risk. The Sales team reports to the DMD through their line; the Credit division reports to Managing Director, while the Loan Administration reports to the Chief Operating Officer. The above arrangement has not only ensured segregation of duties and accountability but also helps minimize the risk of compromise with quality of the credit portfolio.

5.1 PROBLEMS OF SME FINANCING-

Despite the significant contribution of SME sector to the economy, this sector has been seriously suffering from the limited access to financial services. The enterprises in this sector are not small enough to get credit facilities from MFIs and at the same time not large enough to get loans from formal financial institutions. (Bangladesh Bank, 2006). Bangladeshi SME sector is facing several problems. Both borrowers and lenders are facing problems in SME loan processing. Poor infrastructure, lack of information's, lack of utility, lack of skilled manpower, poor monitoring system est. are hampering SMEs growths. For the betterment of the study, problems are defined from both lenders and borrowers perspective-

5.1.1 From lender perspective-

a) Lack of expertise in credit risk management process-

Credit risk measurement is viewed as the most difficult problem in SME financing by banks. The task is especially difficult for SMEs since there is no uniformed credit information or recording practices among SMEs. BRAC Bank Ltd. follows a rigorous information collection by CROs along with sophisticated credit assessment software for SME loan applicants. However, it is still difficult to determine which clients truly deserve loans and by what amount. Due to these difficulties, often a deserving applicant may be refused a loan or sanctioned a lower amount.

b) Lack of relevant information-

Credit information and creditor rights remain relatively weak in developing countries, constraining access to finance in these countries. Credit information in Bangladesh is inadequate and unreliable, particularly to nonmetropolitan SMEs. SMEs cannot take advantage of economies of scale related to accounting, business planning, and market research to the same extent that large firms can do. This may lead SMEs to under-invest

in activities and services that could potentially enhance their transparency and productivity. A credit information bureau operated by Bangladesh Bank contains current loan information for all borrowers of financial institutions regulated by Bangladesh Bank. However, the system does not allow small businesses to build up reputation based credit and borrowers with poor credit cannot be screened.

c) Assessment of the risk bearing exposures and making risk covering provisions-

According to Bangladesh Bank Regulations and latest BASEL II requirements banks have to calculate risk bearing exposures and make provisions. The Basel Committee made some specific changes to accommodate SME Finance. These changes included: (I) calibration of risk-weight functions in a way that, at a given probability of default, exposures to SMEs require relatively less capital than larger firms; (ii) introduction of a specific risk weight curve for SME exposures classified as retail; (iii) reduction of the risk weight for non-mortgage retail exposures under the standardized approach; and (iv) better recognition of credit risk mitigates, particularly collateral and guarantees. The basic problems encountered by the commercial banks in lending to SMEs are: the bank capital adequacy requirements, assessment of the risk-bearing exposures and making risk covering provisions as these assessments are still tricky in case of SMEs.

d) High fixed cost based-

SME financing by bank requires setting up SME units in remote places and hiring huge workforce for selecting and collecting credit information, approaching clients, maintaining regular interaction with each client, monitoring the use of the loan and ensuring regular repayment. This increases the fixed cost base of the bank significantly.

e) High transaction cost-

SME Finance Gap can be directly attributed to the cost of distributing credit. Lending to SMEs causes Higher Operational Cost, but less return. Due to small loan size, the operational cost is higher and they require intensive monitoring and supervision.

f) Lack of low cost fund-

Direct lending to SMEs, which may be subsidized, can take several forms, including provision of lines of credit to financial institutions and co-financing facilities. These lines of credit usually entail conditions to strengthen the capacity of financial intermediaries and prevent market distortions. In our country low cost source funds to be distributed directly to SMEs are still rare.

g) Lack of public policy support-

Ensuring a stable macroeconomic environment, an effective financial infrastructure, and a supportive legal and regulatory framework, is arguably the most important and effective contribution that governments can make to expand the supply of finance to SMEs. However in Bangladesh, the progress of mandatory data reporting to credit bureau, strengthening collateral regime, ensuring creditors rights etc. are still in pretty rudimentary level if not non-existent.

h) Low level financial literacy

A related constraint is lack of financial education. Recent evidence suggests that levels of financial literacy are often low among small business owners, which can potentially pose difficulties for managing a firm's finances effectively. Low levels of financial literacy can prevent SMEs from adequately assessing and understanding different financing options, and from navigating complex loan application procedures. Similarly, the fact that

SMEs' accounting and financial statements are often not transparent makes them risky borrowers and thus less attractive to lenders.

i) Poor low enforcement system-

SME entrepreneurs typically have little land to offer as collateral, but they have movable property ranging from equipment to inventory to receivables. The lack of a functional legal system of registered movable property, other than for public limited companies, is constraining the use of movable collateral. Linked to this is the lack of a central registry to ensure the integrity of such collateral.

j) Liquidity crisis-

It was clearly evident in the banking system through the high call money rate as banks were borrowing money from other banks at a rate of more than 20 per cent at that time. Credit flow to the private sector had declined due to heavy government borrowings from the banking sector. Small-and-medium enterprises (SME) and small investors would be the first to bear the brunt of the liquidity crisis. (Source: theindependentbd.com December 20, 2011)

5.1.2 From borrower perspective-

In SME sector, borrowers face much problem then the lenders. Clearly high interest rate, huge market competitions and lack of business knowledge are the major problems faced by them. Additionally some more barriers are faced by borrowers. That are-

a) High Bank interest rate-

The interest rate of SME is very high comparatively with other loan products. So it becomes difficult for the borrowers to make profit with 13% bank loan. Along with it, in order to cover space rents, utility charges and employees rents SMEs have to do sales products with a 50% rate of their manufacturing cost. The rising interest rate is also pushing production costs up. High costs of production are discouraging SMEs from manufacturing.

b) Lack of information-

Since lender initiates less marketing promotions and advertisement, so borrowers face lack of information. They have no proper information's about the lenders and their procedures. So there is a gap between message conveying by lenders and information received by borrowers.

c) Unavailability of collateral free bank loan-

Since SME sector is risky and defaulter rate is also high, so banks are less willing to provide loan without collateral. It makes loan access difficult for the borrowers. However, some banks developed their loan products in such way so that young entrepreneurs can access loan without collaterals. Empirical evidences suggest that banks do not sanction credit to the SMEs for lack of collateral and high transaction cost (SEDF 2006; Khan et. al., 2003; Khalily et. al. 1994, Rahman et. al. 1979).

d) Lack of modern technology-

No doubt in this fastest moving world, business requires modern technologies. However in Bangladesh small and medium entrepreneurs use traditional technologies to produce theirs

goods and products. So they have little chance to go extensive business and repay the loan in short. Moreover there is a huge market competition with Indian and Chinese market within the country. As result small and medium entrepreneurs face two ways problem. First they could not produce product rapidly due to lack of modern technology. Secondly, even if they become able to manage rapid production anyhow, however they could not compete with cheap foreign substitute products. All those things minimize their profit margins; results enable to reply loan on time.

e) Lack of skilled workforce-

SME entrepreneurs frequently face unskilled labor force problems. There is lack of sector wise skilled manpower which prevent SME sector booming up. For example- though plastic industry is a promising one, Bangladesh is still in lack of skilled and trained labor force in that sector. Labor force of that sector contains minimum education and insufficient knowledge.

f) Lack of entrepreneurship development program-

Though SME foundation has been set up to finance and resolve SME related difficulties; it's not working enough to train entrepreneurs. SME entrepreneurs need professional gaudiness to initiate and run a business in a profitable mood. Lack of knowledge prevents them to engage in profit generating activities.

g) Lack of marketing knowledge-

Small and medium entrepreneurs have minimum knowledge about this competitive market. Hardly they have knowledge about what product should produce, how to sell them, what should be the promotional activities, how to segment market, how to select attractive consumer group ETC. Market is already saturated. Over that, there is a pressure from foreign cheap products. A study conducted by Canadian Integrated Development

Association (CIDA) shows that there are about 6.0 million SMEs in Bangladesh and among them only 27 thousand enterprises is ready to expand and export.

h) Lack of finance literacy among borrowers-

Because of little knowledge about different financial options and lack of financial literacy among borrowers' especially female entrepreneurs a lot of them are initially unwilling or afraid to take loans. This problem is more acute in rural areas than in urban areas.

i) Absence of SME support centers-

It been already said that there are few banks working with SME. Moreover not every bank has sufficient arrangements to provide and monitor SME loan. Unfortunately government also paid little concentration at this point.

j) Longer loan processing period-

Longer loan processing period also hinder borrower to access loan. Generally it takes around one month to approve loan. As a result borrower could not access it when it's emergency.

k) Regulatory requirements-

Regulatory permissions, such as environmental clearance for a manufacturing unit, also discourage entrepreneurs. It takes at least six months to get the required permission from the department of environment, which discourages both borrowers and lenders.

5.2 POLICY COULD BE IMPLEMENTING BY GOVERNMENT:

a) Financial institution capacity building:

Technical assistance could be provided to improve lender skill levels in credit risk measurement and management through financial institution capacity building. Government may play a role in building the capacity of financial institutions to serve the SME sector, frequently with the assistance of international organizations.

b) Business advice networks:

Provide advisory services for enterprises, assisting them in making good investment choices and entrepreneurial decisions. Assistance could be provided in understanding the needs of the SMEs developing appropriate structures/products for servicing the SME clients, training staff and management in SME financing, and managing information and knowledge efficiently.

c) Business registration:

Streamline and standardize business registration processes. Increase transparency of incorporation information to the general public. Provision of data to credit registries/bureaus should be made mandatory, as well as the consultations to the registries/bureaus. This would ensure the rapid build-up of coverage and a reliable database. Moreover, credit registries/bureaus are most effective when their data are electronically accessible and available in real time, and the credit report information (positive as well as negative) is up-to-date and processed in a short time.

d) Accounting standards:

SMEs are typically non-public entities with simple financial transactions. Many of the disclosures aimed at public shareholders and lenders may be unnecessary for SMEs. Greater transparency and reliability of financial accounts would enable more robust risk assessments of SMEs to be undertaken by lenders and other creditors.

e) Infrastructure joint ventures:

Banks may share common platforms where this ensures scale benefits are maximized, but does not affect competition at front line.

f) Financial literacy program:

Promote understanding of financial markets, products and investments through financial education programs. The capacity building of SMEs themselves (financial education, assistance in the development of business plans and loan applications) is important.

g) Policy Monitor-

Bangladesh Bank, the central bank of the country, developed a circular titled “Refinancing Scheme for Women SME” and issued it to all scheduled banks and financial institutions on 7 February 2007. This circular adopted several important provisions for women including 10% quota of its aggregate SME loan will be provided to woman at 5-10% interest rate and collateral free loan for women is up to BDT 1.5 million. Proper mechanism should be in place to verify whether these loans are received actually benefiting the targeted group. Moreover, there should be a measure of subsidy dependence, and a practical and meaningful impact evaluation approach involving a real cost-benefit analysis that assesses whether the positive net impact was worth the cost in subsidy.

h) Legal system:

Establishing a solid financial infrastructure (auditing and accounting standards, credit registries/bureaus, collateral, and insolvency regimes) should be a priority in the financial development agenda of Bangladesh. Policy makers should focus on-

- **Creditor rights:** Ensure creditors' rightful claims on assets to reduce losses during liquidation or bankruptcy proceedings.
- **Bankruptcy law:** Improve efficiency of bankruptcy laws to ensure creditors' rightful claims on assets during bankruptcy.
- **Property rights:** Improve efficiency and ease of registering property and collateral

5.3 CONTRIBUTION OF SME IN BANGLADESH ECONOMY

“The Bangladeshi economy is already enjoying benefits from strong support of its dependable SME sector. SME is the engine of growth in Bangladesh, that can so help the country to become middle –income state by 2012”- said by Aftab Ul Alam, Chair person of the SME foundation in an interview given to the Bangladesh Economy News Update. Undoubtedly SME results large-scale employment and income generating activities relatively low cost in both urban and rural areas. In Asia, SME sector plays even a greater role as the sector constitutes about 98% of all enterprises, accounting for 30% of total employment and 30% of direct exports. Like other developed countries, SMEs brought significant change in economic and social development of Bangladesh. All the promising sectors which were ignorant by formally finance system become the main engine of the country. In the first half of 2012 (Jan- June), SME has contributed BDT 10.463 billion, BDT20.154 billion and BDT1.639 billion in manufacturing, small-medium scale business and service sector respectively. Together, the various categories of SMEs are reported to contribute between 80 to 85 percent of industrial employment and 23 percent of total general employment (SEDF, 2003). According to a study conducted by Canadian Integrated

Development Association (CIDA), there are about 6.0 million SMEs in Bangladesh and among them 27 thousand enterprises are ready to expand and export. According to the *National Private-Sector Survey of Enterprises in Bangladesh, 2003* undertaken by Lisa Daniels (with sample enterprises of 2,126,961) there are approximately six million micro, small, and medium enterprises (MSMEs), which include enterprises with up to 100 workers. About 31 million people are employed in MSMEs or 40 percent of the population 15 years and older. SMEs contribute 50 per cent of total industrial output employing 82 per cent of industrial labor force. SME's contribution to national export is also significant through different industries such as RMG, Jute, Leather, Plastic and fisheries.

Additionally by encouraging woman more and more, huge portion of labor is using to income generating activities which used to set idle at home. After involving with the business woman becoming able to change their social position and enjoying economical benefits. Their decision making abilities are increasing which also considered as major indicator of woman empowerment. In combined with huge workforce, financial supports from different banks, technological advantages and market coordination SME has successfully created some positive impacts on Bangladeshi economy.

The SMEs contributions in Bangladesh are illustrated in following table-

Aspects	Role of SMEs
National Gross domestic product	25%
Gross manufacturing output	40%
Industrial Jobs	80%-85%
Total labour force	25%
Total exporting earning	89%
Percent of business	Over 95%
Absorbed industrial workers	70% to 80 %

Table 5.1- SMEs contributions in Bangladesh (source- SEDF 2003, ADB, World Bank, Planning Commission and BIDS, 2011)

5.4 OBSTACLES AND CHALLENGES FACED BY BRAC BANK LTD.

As a fully SME based financial institution, BRAC faces several challenges in terms of its operation. Working on SME is the biggest challenges of its. Along with that certain government regulations, defaulter rate, absence of high technology, high employee turnover rate ETC hindering BRAC Bank of its growth. The major challenges faced by country's prominent SME provider are given bellow-

1. Business Nature-

One of the major drawbacks of BRAC bank is that it's fully SME based bank. Where other bank has partial SME operation there BRAC bank has partial traditional banking activities. As a result it faces all the inherent risk of SME financing. To overcome these risks and prove SME financing as a profitable business segment was the biggest challenge for BRAC bank at initial stage.

2. Lack of Experience-

Though SME was introduced by 1999, there were no such banks working with SME vastly. Till today most of the banks perform SME as partial wings. For that reason, when BRAC bank started SME financing, there were lack of expertise of this sector. Even no constructive research had been conducted to measure the opportunities and scope of SME. Internal challenges and external risk could failure this initiative.

3. Certain Government Rules-

Government rules tend to change often specially in case of financial situations. Bangladesh Bank has change rules and regulation for SME financing frequently to cope up with fluctuating economic situations. That crates problem for BRAC bank to

redesign/alter policies often. It also hampers work flows and consume policy level implication period.

4. Lack of modern technology-

Though BRAC bank has automated banking software, it's not sufficient enough to operate fully on online. At the same time internet facilities over the country is not well developed. That prevents BRAC bank to work flawlessly.

5. Economical situation-

Recently Bangladeshi economy is facing several crises which also affect banking situation. Along with Bangladesh Bank itself, Shonaly and Rupali Bank (two major public banks) are taking huge loan from money market every day. Of course those loans are taking from different private bus at lower call money rate. On the other hand inter banking call money rate is comparatively high. That creates a negative impact on the working capital of banks. Moreover recently high inflation rates, high interest rate ETC are discouraging people to save more. All those things created liquidity crises at market. Like other bank, BRAC bank is also facing financial constrains.

6. High employee's turnover rate-

BRAC bank follows strict Human Resource policies. At the same time it tries to accomplish all activities in cost effective manners. It results huge pressure on employees. Moreover with BRAC bank experience any opportunity seekers could get new job with high salary. It makes high employee's turnover at BRAC bank. High employee turnover affect BRAC bank two ways. Firstly bank sometimes loses voluble employees, and secondly it takes time to train up new blood.

6.1 RECOMMENDATIONS-

To overcome challenges faced by SME is not easy. Both the government and individual organization need to concern about it. Some general instructions already discussed previous section. This section will recommend some policy could be adapted by BRAC Bank Ltd specifically.

To overcoming the barriers discussed in previous section following policies can be implemented-

- 1.** Reduce the interest rate- Because many of their competitors are providing loans at a lower rate. For example most of the competitors banks providing loan at 12-15% interest rate.
- 2.** Increase amount of SME loan approval by the Zonal officer, at present they can approve up to 5 lacs.
- 3.** Train the Customer Relationship officers more comprehensively and realistically so that customers may not face any trouble while getting and repaying the loan.
- 4.** Some times CROs, bank staffs or direct sales tem select potential borrowers in order to meet sales target. It's a major reason of defaulter. So BRAC bank should not put excessive pressure on employees because at the end of the day it hampers bank reputation.
- 5.** Provide technical support to the borrower (if necessary) so that they can utilize their loan amount.
- 6.** Organize entrepreneurs meeting to train them up according to the business type.
- 7.** Prepare retail division staffs specially front line employees about SME vastly. Because most people do come to retail branch in order to get information's.
- 8.** A loan approval procedure is lengthy. This should be reducing.

9. Borrower's assessment and monitoring system should be stricter. Current defaulter rate says that there are some weakness in loan approval and monitoring system.
10. More media converge is needed to inform potential borrowers about products and services. There TV advertisement and radio coverage could be strong media.
11. BRAC bank can share common platform in order to provide SME loan. It can jointly work with other financial institutes without hampering profits. For example entrepreneur training session could be arranged jointly with SME Foundation.
12. Increase marketing activities in the urban area because other competing industries are given huge ad in urban area which helps them to increase their customer base.
13. Management lobbying is considered as significant reason of credit default. So BRAC bank should increase monitoring such kind of lobbying and provide ethical training to the loan approval people.
14. BRAC bank should have separate banking division for woman. This will encourage woman in banking activities.
15. Analyze customers' behavior that what type of customer makes default and stop giving them SME loan.
16. Risk Management department's audit report should be more strict and reliable so that possible defaulter may not get the loan.
17. Increase the remuneration and compensation package for the entry and mid level management otherwise BBL can't retain the efficient and experienced employees

6.2 CONCLUSION-

In recent days the Small and Medium Enterprise (SME) Financing has become an important area for Commercial Banks in Bangladesh. To align its corporate policy with the regulation of Central Bank, banks have become more concerned about SME and opened windows to conduct business in this particular area.

BRAC Bank Ltd. has been established on the visionary to finance “missing middle” in order to economic development of the country. With its unique thinking and impressive business strategies it has proven small and medium enterprises as an emerging economic opportunity. At the same time win-win situation of both the lender and borrowers’ have encourage other financial institutions of the country.

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