Bangladesh Bank
The People's Republic of Bangladesh

Preparatory Survey on Financial Sector Development for Small and Medium-sized Enterprises

Bangladesh

Final Report

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JAPAN INTERNATIONAL COOPERATION AGENCY

OPMAC Corporation

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Currency equivalent
(as in May, 2010)

Tk 1.00	=	USD 0.0144
Tk 1.00	=	Japanese Yen 1.323
USD 1.00	=	Tk 69.299
Japanese Yen	=	Tk 0.756

Abbreviations and Acronyms

ACSPD	:	Agricultural Credit and Special Programs Department of BB
ADB	:	Asian Development Bank
ADP	:	Annual Development Programme
ASEAN	:	Association of South-East Asian Nations
BASIC	:	Bank of Small Industries and Commerce
BB	:	Bangladesh Bank
BBS	:	Bangladesh Bureau of Statistics
BBTA	:	Bangladesh Bank Training Academy
BEI	:	Bangladesh Enterprise Institute
BEIOA	:	Bangladesh Engineering Industry Owners' Association
BFID	:	Bank and Financial Institution Division
BICF	:	Bangladesh Investment Climate Facility
BOI	:	Board of Investment
BSCIC	:	Bangladesh Small and Cottage Industries Corporation
BKB	:	Bangladesh Krishi Bank
BRPD	:	Banking Regulation and Policy Department
BSB	:	Bangladesh Shilpa Bank
BSRS	:	Bangladesh Shilpa Rin Sangtha
BWCCI	:	Bangladesh Women's Chamber of Commerce and Industry
CCI	:	Chamber of Commerce and Industry
CIB	:	Credit Information Bureau of BB
CIDA	:	Canadian International Development Agency
CIF	:	Cost, Insurance and Freight
CPI	:	Consumer Price Index
CRR	:	Cash Reserve Requirement
DCCI	:	Dhaka Chamber of Commerce and Industry
DFID	:	UK Department for International Development
DOS	:	Department of Off-site Supervision of BB
DBI	:	Department of Banking Inspection of BB
DFIM	:	Department of Financial Institutions and Markets of BB
E/A	:	Executing Agency
EC	:	European Commission
ECAI	:	External Credit Assessment Institution
ECC	:	Environmental Clearance Certificate

EDF	:	Export Development Fund
EDGE	:	Economic Development and Growth with Equity
EEF	:	Equity and Entrepreneurship Fund Unit of BB
EGBMP	:	Enterprise Growth and Bank Modernization Project (IDA-assisted project)
EIA	:	Environmental Impact Assessment
EKN	:	Embassy of the Kingdom of the Netherlands
EPZ	:	Export Processing Zone
FBCCI	:	The Federation of Bangladesh Chamber of Commerce and Industry
FCBs	:	Foreign Commercial Banks
FD	:	Finance Division
FDI	:	Foreign Direct Investment
FOB	:	Free On Board
FY	:	Fiscal Year
GATE	:	Greater Access to Trade Expansion
GDP	:	Gross Domestic Product
GDS	:	Gross Domestic Saving
GNI	:	Gross National Investment
GNS	:	Gross National Saving
GOB	:	Government of Bangladesh
GTZ	:	Gesellschaft fur Technische Zusammenarbeit
GVA	:	Gross Value Added
ICA	:	Investment Climate Assessment
ICB	:	Investment Corporation of Bangladesh
ICT	:	Information and Communication Technology
IDA	:	International Development Association
IFC	:	International Finance Corporation
IMF	:	International Monetary Fund
INSPIRED	:	Integrated Support to Poverty and Inequality Reduction through Enterprise Development
JBIC	:	Japan Bank for International Cooperation
JICA	:	Japan International Cooperation Agency
JST	:	JICA Survey Team
LA	:	Loan Agreement
MDG	:	Millennium Development Goal
MFI	:	Microfinance Institution
MOC	:	Ministry of Commerce

MOF	:	Ministry of Finance
MOI	:	Ministry of Industries
MOU	:	Memorandum of Understanding
MRA	:	Microfinance Regulatory Authority
MSME	:	Micro-enterprises and SME
NBFIs	:	Non-Bank Financial Institutions
NCID	:	National Council for Industrial Development
NDRE	:	Non-Development Revenue Expenditure
NSC	:	National Savings Certificates
NSD	:	National Saving Deposit
NSARP II	:	National Strategy for Accelerated Poverty Reduction II
ODA	:	Official Development Assistance
OPP	:	Outline Perspective Plan
PAMA	:	Policy Analysis Monitoring and Assessment
PAU	:	Policy Analysis Unit of BB
PCBs	:	Private Commercial Banks
PFIs	:	Participating Financial Institutions
PIU	:	Project Implementation Unit
PRICE	:	Poverty Reduction by Increasing the Competitiveness of Enterprises
RAKUB	:	Rajshahi Krishi Unnayan Bank
PRSP	:	Poverty Reduction Strategy Paper
RMG	:	Ready-Made Garment
ROA	:	Return on Assets
ROE	:	Return on Equity
SAARC	:	South Asia Association for Regional Cooperation
SBs	:	Specialized Banks
SCBs	:	State Commercial Banks
SDC	:	Swiss Agency for Development and Cooperation
SEDF	:	South Asia Enterprise Development Facility
SEZ	:	Special Economic Zones
SLR	:	Statutory Liquidity Requirement
SME	:	Small Medium Enterprise
SMEF	:	SME Foundation
SMESDP	:	Small and Medium Enterprise Sector Development Program (ADB assisted program)
SMESPD	:	SME & Special Programmes Department of BB

S/W	:	Scope of Work
TA	:	Technical Assistance
TCE	:	Total Capital Employed
TFP	:	Total Factor Productivity
TOR	:	Terms of Reference
UNESCAP	:	United Nations Economic and Social Commission for Asia and the Pacific
USAID	:	United States Agency for International Development
WB	:	The World Bank

Note

Crore	10,000,000
Lac	100,000

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SUMMARY

1. Outline of the Survey

1.1 Background of the Survey

Bangladesh, where the poor accounts for 40% of the total population, is one of the poorest countries. The Bangladeshi economy, however, has recorded a remarkable performance over recent years with about 6 percent annual growth, and impact of the financial crisis is relatively small. Such trends are expected to continue. It is estimated that 20 to 30 percent of the economic value added has been generated by Small and Medium-sized Enterprises (SMEs) and that 70 to 80 percent of non-agricultural labor force works for SMEs. SMEs play a critical role in economic growth and poverty reduction so that sound development of SMEs is fairly important for Bangladeshi economic development. This is supported by that Bangladesh's national development strategy put priorities on SME sector development.

Regarding the bottlenecks in further growth of SMEs in industry, electricity shortage, road inaccessibility, insufficient institutional support and SMEs' limited access to finance from the formal banking system are generally pointed out. In Bangladesh, the banking sector has focused on lending to large enterprises over a certain size and microfinance institutions have provided financial services to the poor. On the other hand, SMEs, which are between large enterprises and the poor microenterprises, are subordinated to them in terms of the access to finance. The Government of Bangladesh (GOB) recognized this issue and has made efforts to facilitate SMEs' access to the banking sector through expansion of money supply facilitation scheme vie BB and the improvement of credit capacity with the assistance of donors in order to address them. Moreover, measures such as development of SME Policy strategies and establishment of SME Foundation (SMEF) have been implemented by Ministry of Industry (MOI). While such efforts have contributed to an improvement, a majority of the financing needs of SMEs seem yet to be met.

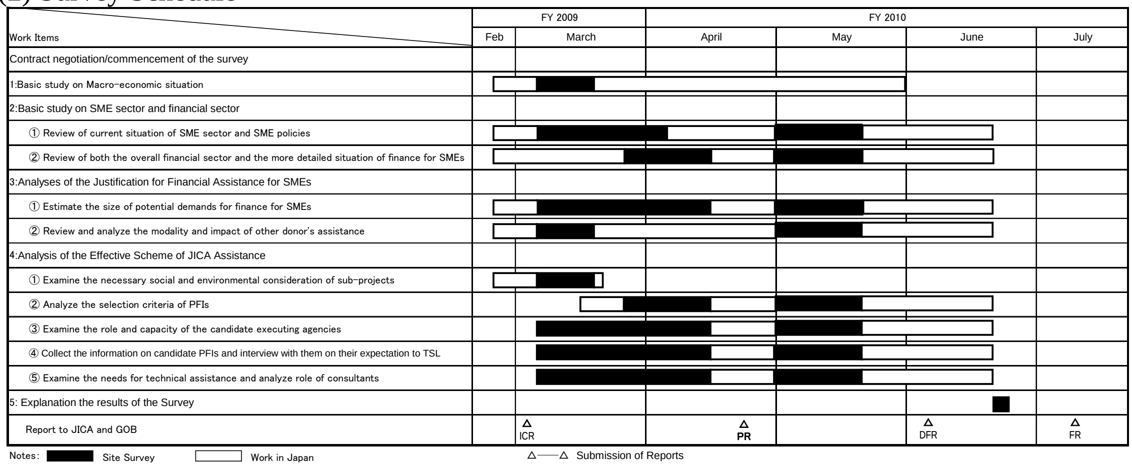
State Commercial Banks (SCBs) had a major presence in the Bangladeshi financial sector and it was hardly said that financial intermediation sufficiently functioned. On the other hand, the financial sector has actively increased lending in order to respond to the funding requirement in accordance with the economic growth last several years. However, there is still plenty of scope for financial deepening. SME financial sector has been developed mainly in short-term lending market for commercial sector. It is inevitable to strengthen the foundation of manufacturing sector. Therefore, it is necessary to respond appropriately to the mid-/long-term financial requirements from mainly manufacturing sector.

1.2 Objective of the Survey and Survey Schedule

(1) Objective of the Survey

To conduct a basic analysis on current situation and relevant policies of SME sector and SME financial sector in Bangladesh and SMEs' potential demand for mid-/long-term loans and to examine the relevancy of the proposed project.

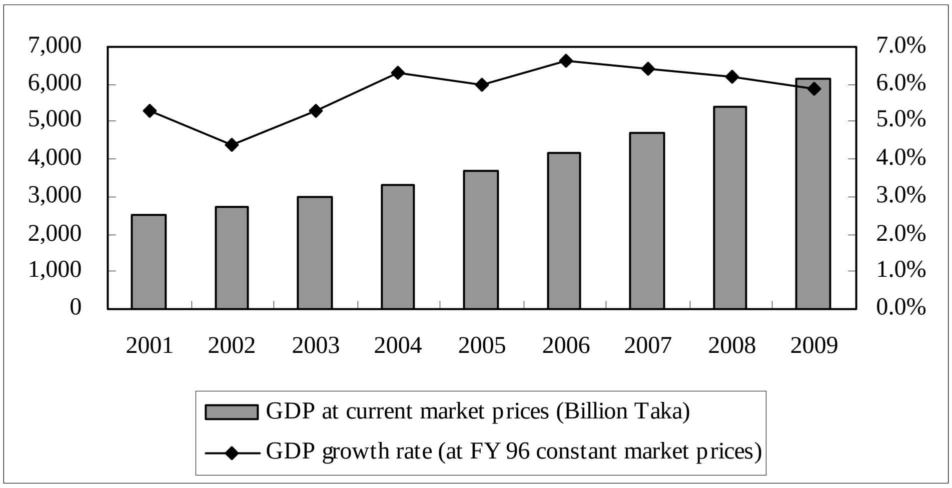
(2) Survey Schedule



2. Economy and Relevant Policies

2.1 Macro-economic situation

Bangladesh has achieved around six-percent growth rate during recent years thanks to a growth of agricultural sector and the resilience of private consumption supported by buoyant inflows of workers' remittances. The manufacturing sector has the largest share (17%) of the real GDP in 2009 among all subsectors, and in particular production by large and medium scale enterprises accounts for more than 70% out of total production in the manufacturing sector.



Source: Bangladesh Bank, Annual Report 2008-2009

Note: Figures on FY09 are provisional.

Figure 1 : Trends of GDP (current market price) and growth rates

While the share of the agriculture and fishing sector was less than 20% in FY2006 GDP, the labor force in the agriculture, forestry and fisheries sector accounts for about half of the total labor force. It is the largest sector to provide employment opportunities. But its share has been decreased recently. This is followed by the service sector, which accounted for 37.34% in FY 2006 and the share has been increasing. The share of sub-sector of trade, hotel and restaurants in particular, is high (16.45％ in FY). The share of the manufacturing sector is relatively small, but it showed a steady growth over the period. The labor force in the manufacturing sector is 10.97％ in FY 2006 out of the total labor force.

Table 1: Share of employed labor force (aged above 15 years) by sector

Sector	FY 1999/00	FY 2002/03	FY 2005/06
Total Population (million)	128.1	133.4	138.8
Labor force	40.7	46.3	49.5
(Annual growth rate of labor force)		4.4%	2.3%
Employment (million)	39.0	44.3	47.4
(Annual growth rate of employment)		4.3%	2.3%
Out of which: (%)			
Agriculture	**50.77**	**51.69**	**48.10**
Industry	**13.08**	**13.56**	**14.55**
- Manufacturing	9.49	9.71	10.97
Services	**36.16**	**34.75**	**37.34**
- Trade, Hotel and Restaurants	15.64	15.34	16.45
- Transport, Storage and Communication	6.41	6.77	8.44
- Community and personal services	13.08	5.64	5.49

Source: Bangladesh Ministry of Finance, Bangladesh Economic Review 2009, statistics on labor force and employment are quoted from the Policy Paper 0806 of BB titled "A Note on the Contribution of Small and Medium Enterprise to GDP in Bangladesh," June 2008.
Note: Population aged above 15 years of age has been counted as labor force in the figures for 2002/03 and 2005/06, but for the figures for FY 1999/00 the criterion for counting the labor force was the population above 10 years.

2.2 Government sector

Although public finance in Bangladesh is characterized by persistent deficits (4.1% of GDP in case of FY 2009), it maintains the sustainable level. Tax revenue has been modestly increasing. Regarding expenditure, the development budget has been constantly underspent and the non-development expenditure has occupied more than 50% of the total expenditure. The utilization of the Annual Development Programme (ADP) has been hovering at around 80%. The fiscal deficits have been financed by foreign aid and international and domestic bank/non-bank borrowing. Treasury bills and National Savings Certificates (NSC) accounts for around 40%, respectively, of the domestic borrowing and one of the major investments for the domestic financial sector.

2.3 Recent Economic Situation in Bangladesh and Trend of External Sector

The Bangladeshi economy was only mildly impacted by the ongoing global slowdown. Increased domestic production in crops and the resilience of the service sector helped the real economy to remain steady. The characteristics of Bangladeshi external trade are the high rate (82%) of Ready Made Garment (RMG) and high dependency (80%) on low-end markets in North American and in European countries. The garment industry partially depends on imported raw materials for production. Therefore, it is the structure that an increase in imports reflected an increase in exports partly. Bangladesh imports petroleum products, capital machinery and rice. Trade balance is underlying deficit. On the other hand, the volume of remittances form overseas workers has been increasing. Since the remittances (reported in current-account transfer) make up with the trade deficit, the current account balance has accounted surplus for last 9 years except FY 2001 and FY 2005. The recent increase of inward remittances results in appreciation pressure of taka. However, the Bangladesh Bank (BB) makes stabilizing transaction by equalization intervention. The recent statistics reveal an impact on the country's economy in terms of external trade, the number of Bangladeshi overseas workers and foreign direct investment (FDI). It is necessary to focus on the future trends.

2.4 Development Policies

In National Strategy for Accelerated Poverty Reduction II (NSAPR II (2009-11), SME development is emphasized as one of the pro-poor economic growth strategies. Regarding the access to finance among constrains faced by the SME sector, NSAPR II envisions that the policy needs to feature the following points:

(1) Increase in the flow of formal private sector credit into the SME sector;
(2) Scaling down of collateral requirements for SME loans and a switch from immovable assets to movables assets for collaterals; and
(3) Lowering of high interest rates charged on SME loans by the commercial banks.

The current government launched draft long-term strategy for economic development, naming Outline Perspective Plan of Bangladesh 2010-2021 - Making Vision 2021 A Reality - (OPP), replacing NSAPR II. This OPP aims at becoming a middle-income country by 2021 so that it sets the economic growth rate at around 8 to 10% per annum as a target. in order to achieve the macroeconomic performance targets for 2021, the OPP pursues increasing investment (total investment will be raised from 24.2% against GDP in FY 2009 to 32.1 in FY 2015 and 37.5% in FY 2021), accelerating industrialization, in particular promoting manufacturing sector and SME-based industrialization.

3. Small and Medium-sized Enterprises in Bangladesh

3.1 Definition of SME

A number of definitions of SMEs have existed in Bangladesh. In 2008, BB, MOI and other concerned agencies unanimously agreed with a new definition of SMEs. The following summarizes the current definition of SMEs adopted by BB:

Small enterprise

Sector	Total Fixed Assets excluding land and building (Tk million)	Employment of Labour up to
Services	0.05 – 5.0	25
Trading	0.05 – 5.0	25
Manufacturing	0.05 – 15.0	50

Medium enterprise

Sector	Total Fixed Assets excluding land and building (Tk million)	Employment of Labour up to
Services	5.0-100.0	50
Trading	5.0-100.0	50
Manufacturing	15.0-200.0	150

MOI is currently in the process of drafting the Industrial Policy 2010, which will provide a new definition of SMEs.

3.2 Current Situation for the SME Sector

In Bangladesh, SMEs used to be sometimes grouped into MSME (Micro, Small and Medium Enterprise) together with micro enterprises and cottage industries. There is an estimate that MSME (non-agricultural enterprises with up to 100 employees) contributed to 20% - 25% of the GDP (although the contribution made by micro enterprises was large) with 6 million enterprises employing 31 million (the study conducted in 2003). According to the statistics of small and medium enterprises in the manufacturing sector, whose availability of the statistics is relatively good compared to other sectors, it was estimated that the share of SMEs in 2003 was 4.2% in terms of establishments, but was 12% in terms of the employment and 32% in the Gross Outputs. In Bangladesh, it has been found that firm size is negatively associated with firm labor productivity and firm Total Factor Productivity (TFP) due to the protection of larger firms. It was pointed out that financial intermediation failed to allocate resources efficiently into more productive smaller firms.

Under the investment climate in Bangladesh (the IFC study in 2008), business constraints for firms ranged from the "electricity" to "political instability", "corruption", "access to land", "access to financing", "macro instability (inflation)" and so on. In cases like the power, access to land and financing, similar types of constraints have put severer constraints on SMEs than large firms.

3.3 SME Promotion Policy

In Bangladesh, the SME policy took its position in their efforts of reducing poverty while accelerating the economic growth. The SME promotion policy started being prepared from around 2003, and the SME policy strategies were formulated in 2005. With the supports from donors, a number of concrete measures has been taken such as introduction of refinance schemes for small enterprises by BB in 2004, establishment of the SME Foundation in 2006, which was tasked to implement the SME policy and facilitate development of SMEs. As of the JICA Survey period, the Industrial Policy and SME policy strategies were in the process of being updated. In March 2010, a new SME policy was announced by BB, which showed a more integrated approach toward SME development. In the draft Industrial Policy 2010, BB's refinance schemes are regarded as measures to address market failures.

4. Financial Sector for SMEs in Bangladesh

4.1 Financial Sector in Bangladesh

The financial system of Bangladesh, in particular, the banking system consists of Bangladesh Bank (BB) as the central bank, four (4) state-owned commercial banks (SCBs), five (5) state-owned specialized banks (SBs), 30 domestic private commercial banks (PCBs) including seven (7) Islamic banks, nine (9) foreign banks (FBs).

Table 2: Structure of Banking System (as of December 2008)

Tk billion & %

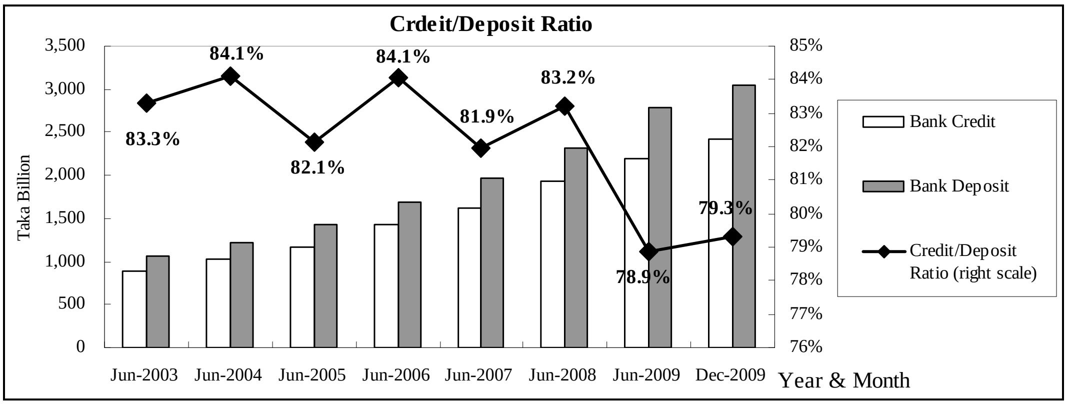
	No. of Banks	No. of Branches	Total Assets (Tk billion)	% of Total Banking Industry	Deposits (Tk billion)	% of Total Banking Industry
SCBs	4	3,386	1,030.9	31.1	758.8	29.7
SBs	5	1,362	222.3	6.7	137.8	5.4
PCBs	30	2,082	1,794.5	54.2	1,450.7	56.6
FBs	9	58	265.8	8.0	214.1	8.4
Total	48	6,886	3,313.5	100.0	2,561.4	100.0

Source: Bangladesh Bank, "Annual Report 2008-09"

In addition, there are 29 non-bank financial institutions (NBFIs).

4.2 Lending and Deposits at Financial Institutions

The outstanding balance of bank credit grew at an average rate of 16.3% during FY 2004 through to FY 2009, surpassing the average growth rate of nominal GDP which grew at an average rate of 12.7% during the same period. Bank deposits grew also steadily at an average rate of 17.4%. The credit to deposit ratio has been moving within a narrow range between 82% and 84% during FY 2003 through FY 2008 but has moved out of the range to 79% in FY 2009.

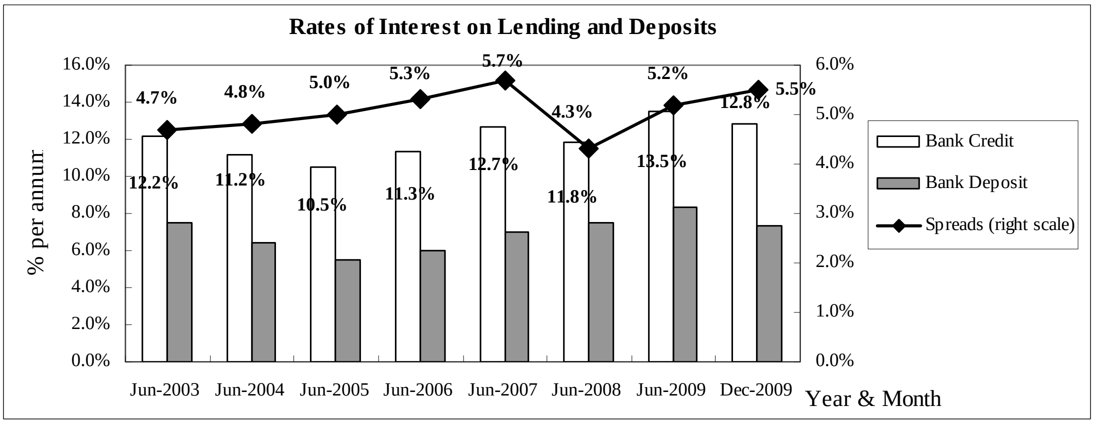


Source: BB, "Annual Report 2008-09"

Figure 2: Credit to Deposit Ratio

4.3 Rate of Interest

The review of the rates of interest during the same period with the above reveals that the interest rate for deposits (weighted average of the scheduled banks) was on a declining trend during FY 2003 to FY 2005 but turned upward and increased from FY 2005 to FY 2009 reaching to 8.3% in FY 2009. Throughout the period, the lending rate of interest has remained at a level exceeding 10%. The lending rate reached to 13.5% in FY 2009. The interest spread between the lending and deposit rates has also remained at a high level of four to six percent. The high spread stems obviously from the inefficiency in the management and the weakness in the financial intermediation function of the financial institutions that needs to be vigorously addressed. The weakness of the intermediation function is typically recognizable in the phenomenon such as; low credit to deposit ratios, excess liquidity, etc. BB has moved to cause the interest rate to decline by instituting such measures as; imposing a ceiling on commercial banks' lending to priority sectors; lowering of repo rates drastically in its resumption, etc.

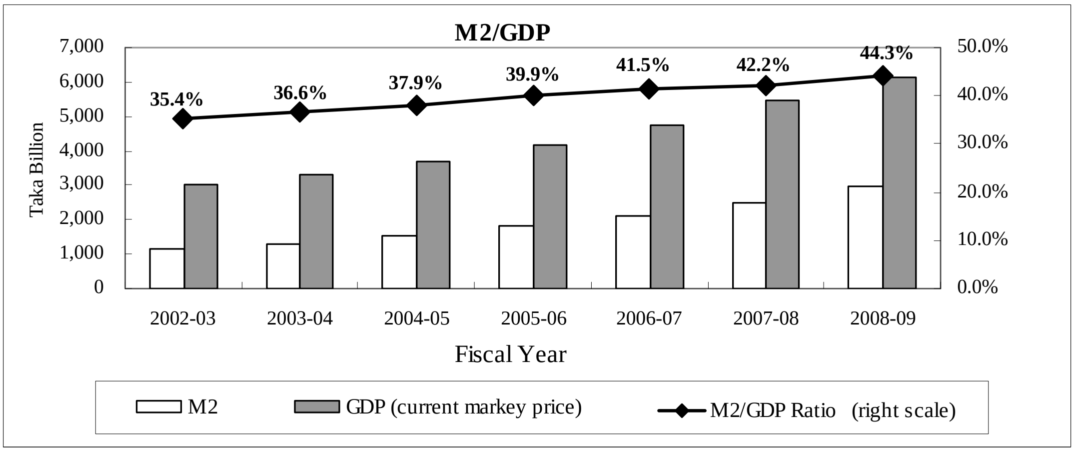


Source: BB, "Annual Reports 2008-09" and "Monthly Economic Trend" March 2010

Figure 3: Rate of Interest on Lending and Deposit

4.4 Monetary Policy and Money Supply

BB operates the reserve money program to target a growth path for broad money consistent with the target growth of nominal GDP and inflation. BB utilizes the monetary policy instruments of; i) open market operation through repo, reverse repo and BB bills, ii) variation in reserve ratios, iii) secondary trading, iv) discount rate, and v) moral suasion. The regulatory norms are currently set as; 5.5% for cash reserve ratio (CRR) and 18.5% for statutory liquidity requirement (SLR). The official discount rate stands at 5.0%.

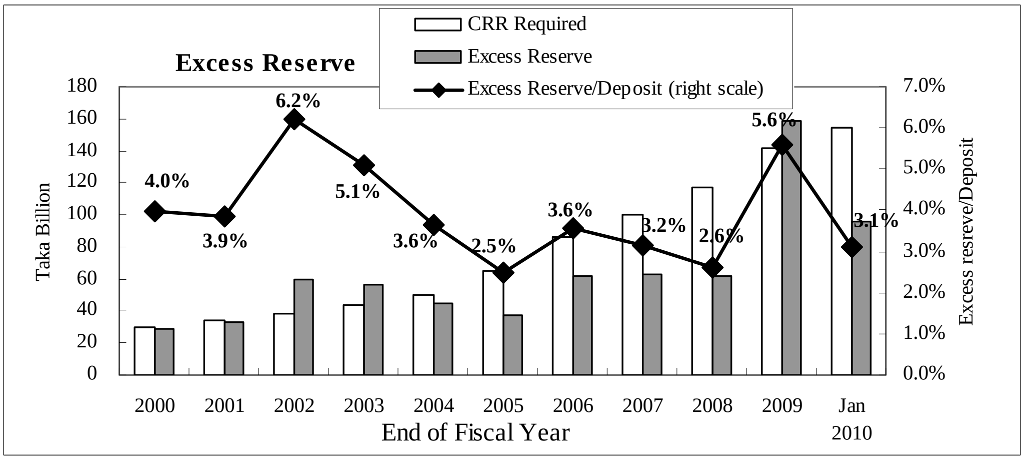


Source: BB, Annual Report 2008-09

Figure 4: Broad Money (M2) / Nominal GDP

4.5 Excess Liquidity at Financial Institutions

Scheduled banks are regulated to maintain a prescribed ratio of cash reserve and statutory liquidity. Depending upon the financial environment, these ratios happen to be excessive. Under such circumstances, financial institutions may be confronting with difficulties of effectively utilizing the funds collected through deposits by bearing certain cost for collection and of aggravation in the efficiency. The historical movement of excess reserve is shown in the following figure:



Source: BB, “Monthly Economic Trends” March 2010

Figure 5: Excess Reserve

The excess reserve of the scheduled banks as a whole hit the bottom in FY 2001 when the inflation had been subsided and interest rates were on a declining trend. Then the ratio turned downward to reach and stay at the level of below 4% of the total deposits. The ratio exhibited a sharp uptrend since March 2009 and hit the second peak of 5.6% in June 2009. The ratio took the other turn for going downward since then. The excess cash reserve as well as the excess liquidity ratio stands at the levels which are lower than the peaks and it appears as if the excess issues were the ones in the past.

4.6 Financial Sector Reform

Upon independence, the entire banking system was once nationalized. The policy culminated in a deep financial crisis that had lingered a long time. Under the nationalized regime, bank loans were mostly directed by the government to the public sector enterprises without being examined under a proper appraisal process for commercial viability. The loans thus lent became sour and their recovery was poor. The financial soundness of the nationalized banks deteriorated as they were trapped in insolvent positions. Being cognizant of the situation, the government launched the financial reform process since 1980s. The reform process got momentum since 2000s by receiving the assistances of the World Bank and IMF. The reform process undertaken included a variety of measures including but not limited to; the revision of the Banking Law; transfer of the supervisory authority of state-owned banks from Ministry of Finance to Bangladesh Bank; replacement of banks' management and hiring of new management; corporatization of state-owned commercial banks; establishment of the managerial goals at banks through signing of MOU and monitoring; disposition of NPLs; wiping out of the accumulated loss in the balance sheet, etc. Thanks to the process executed, the financial health of state-owned commercial banks improved with exception of Rupali Bank so as to clear the capital adequacy ratio regulated by the central bank.

While the state-owned commercial banks confronted with their managerial problems and expansion of business was restrained, privately owned commercial banks expanded their activities to emerge as the leading force in the banking sector. The market share of the state-owned commercial banks for lending retreated from 45.6% in FY 2002 to 29.7% in FY 2008, whereas the share of the privately owned commercial banks expanded from 36.2% in FY 2002 to 29.7% in FY 2008.

4.7 Regulatory Control and Supervision of Financial Institutions

Bangladesh Bank is authorized and in charge of exerting the regulatory control and supervision of the financial institutions. There exist a large number of rules and regulations imposed, out of which the ones of particular importance are recognized in the rules such as; minimum capital requirement; risk weighted capital adequacy; asset classification and provisioning; various exposure limits; cash reserve ratio and statutory liquidity ratio; corporate governance, regulation on interest rates; guidelines for SME lending; etc.

4.8 Performance of Financial Institutions

The performance, soundness and aptitude of the financial institutions for better serving SMEs with equipment and machinery loans are measured by various indicators, among which the items of importance are; availability of enabling network for easier access to SMEs; compliance with regulatory requirement including minimum capital requirement, capital adequacy ratio, etc.; and other items such as loan to deposit ratio, medium/long term lending ratio, non-performing loans, maturity matching of the medium/long term loans and deposits, etc. The JICA survey identified that the non-performing loans (NPL) rations are acknowledged to be on a steady improvement trend both in respect of the banking system as a whole and each group of banks although the levels of NPLs recorded at state-owned commercial banks and specialized banks remains till very high, and that the maturity mismatch exists conspicuously at private commercial banks.

4.9 Activities of Financial Sector for SMEs

The outstanding balance of SME loans almost doubled from Tk 247.24 billion as of the end of June 2008 to Tk 474.95 billion as of the end of June 2009.[1] The share of loans to SMEs was about 20% of the total outstanding balance of bank advances as of the end of June 2009. In terms of types of financial institutions, PCBs' share was as high as 52% and loans to the trade sector accounts for 54 % of the outstanding balance of loans to SMEs, presumably that most of these loans were working capital loans in relatively shorter terms. If the outstanding balance of

[1] It should be noted, however, that the definition of SMEs was revised in 2008

loans to large enterprise and SMEs in the manufacturing sector is compared with estimated contributions of large enterprises and SMEs to added values as of the end of FY 2009, it is assumed that allocation of loans to SMEs is not comparable to the extent to which SMEs contributed to GDP. This is applied especially for small enterprises. In addition, in terms of an outstanding balance per loan, it is assumed that the frequency of loans with a range from Tk 3 million to Tk 10 million is far fewer than that of loans less than this range, i.e. a range from Tk 1.0 million to Tk 2.0 million.

SMEs have limited access to finance in terms of collaterals, the level of interest rates, loan maturity periods and so on. Generally speaking, large enterprises have better access to finance than SMEs do. However, according to interviews during the survey period, micro-enterprises are considered to have relatively good access to micro credit due to existence of many Microfinance Institutions (MFIs). On the other hand, it is considered that enterprises that have graduated and wish to grow further are placed in the middle segment and it is important to take policy measures to improve their access to finance.

As for financial supports to SMEs, there exist refinance schemes of BB, various loan products to SMEs by banks and NBFIs with their own funds, and financial supports by SMEF (pre-finance scheme). Among these supports, refinance schemes of BB have been implemented with the assistance from donors and the accumulated amount of disbursement reached Tk 15.41 billion as March 2010.[2] For the purpose of formulating the proposed project, a lot of lessons will be learnt from experiences of actual implementation of these schemes to be described in the next chapter.

4.10 Estimation of gaps of medium-and long-term funds for SMEs

Demands on SMEs' investment funds, including medium-and long-term investment loans for equipment and facilities, out of Gross Investment are estimated as in Row (E) in Table 3 below while supplies of medium-and long-term investment loans for equipment and facilities, etc. to SMEs by banks and financial institutions are estimated as in Row (N) in the same table. Based on these estimates under the conditions given in the footnote to the table, financing gaps are calculated as in Row (O).

Table 3: Comparison of estimated investment demand (based on IMF's projection) and SME loans

Unit: Tk billion

FY	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Estimate of investment demand by SMEs							
Projected GDP in current prices **(A)**	6,149.0	6,867.0	7,698.0	8,568.0	9,536.0	10,563.0	11,700.6
Private investment **(B)**	1,143.7	1,304.7	1,478.0	1,662.2	1,859.5	2,133.7	2,363.5
(B)/(A) (%)	18.6%	19.0%	19.2%	19.4%	19.5%	20.2%	20.2%
Investment in Machinery/factory etc **(C)**=(B)*55%	629.04	717.59	812.90	914.21	1,022.73	1,173.54	1,299.93
Loans from FIs **(D)**=(C) *19%	119.52	136.34	154.45	173.70	194.32	222.97	246.99
SME demand for investment **(E)**=(D) * 35%	41.8	47.7	54.1	60.8	68.0	78.0	86.4

[2] Comments on the progress report from the MOF.

FY	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Estimated source of SME loans (if SME loans continue to be extended in accordance with the growth of private sector credit)							
Estimated M & L loans for SME (Outstanding) **(F)**	157.34	182.04	212.26	247.50	289.82	339.67	398.09
Out of which: Loans for investment **(G)**=(F) * 55%	86.54	100.12	116.74	136.12	159.40	186.82	218.95
Out of which, repayment **(H)**=$(G)^{-1}$/5	14.51	17.31	20.02	23.35	27.22	31.88	37.36
(I)=Total deposit	2,786.8	3,193.7	3,695.1	4,308.5	5,023.7	5,882.7	6,888.7
M/L deposit **(J)**=(I) * 35%	975.4	1,117.8	1,293.3	1,508.0	1,758.3	2,059.0	2,411.0
Loans to SMEs **(K)**=(J)*20%	195.08	223.56	258.66	301.60	351.66	411.80	482.20
Loans for investment **(L)**=(K)*55%	107.29	122.96	142.26	165.88	193.41	226.49	265.21
Incremental increase of outstanding balance **(M)**=(L)-$(L)^{-1}$	18.08	15.66	19.31	23.62	27.53	33.08	38.72
Total supply of loans **(N)**=(H)+(M)	32.59	32.97	39.33	46.97	54.76	64.96	76.08
Estimated amount of gaps in investment loans							
(O)=(E)-(N)	9.2	14.7	14.7	13.8	13.3	13.1	10.4

Source: Estimate of the JICA Survey Team based on the IMF projection of the GDP (IMF 2010) and BB’s annual report 2008-2009.

Note 1: In order to make projection for FY 2014-15, the same growth rates as used in FY 2013-14 have been applied.

Note 2: The following conditions and estimates have been made to estimate financing gaps, differences between investment demands of SMEs and a total amount available for medium-and long-term investment loans to SMEs : (C)＝out of the private investment, investment in machinery, factories, facilities, etc. is estimated at 55%;(D)＝financing for investment from formal financing institutions is estimated at 19%;(E)＝investment demand by SME is estimated at 35% (flow)；(G）＝out of industrial term loans for SMEs, working capital loans are estimated at 45% while investment loans at 55% ; (H)＝out of the outstanding balance at the end of the previous year, one-fifth is repaid during the current year；(J)＝out of the outstanding balance of the total deposits, medium-and long-term deposits are estimated at 35% ; (K)＝out of medium-and long-term deposits, possible sources for SME loans are estimated at 20%；(M)＝out of medium-and long-term loans to SMEs, investment loans are estimated at 55%；(N)＝incremental differences in the outstanding balances of medium-and long-term deposits for investment loan sources to SMEs are calculated；a total sum of amounts in rows (H) and (M) is estimated at the amount that could be supplied to SMEs for medium-and long-term investment；(O)＝differences between investment demands of SMEs (E) and a total amount that could be supplied as medium-and long-term investment loans to SMEs (N) are considered as estimated financing gaps.

5. Other Donors’ Assistance

5.1 Overview of the other donors’ assistance and possible collaboration with other donors

Bangladesh receives assistance from several donors for SME development. ADB and the World Bank extend loans to inject funds into the Bangladesh Bank’s refinance scheme. The refinance scheme is not necessarily a convenient scheme for financial institutions in terms of rationing to women enterprises, lengthy process of loan administration, ex-post facto rationing and so on. Moreover, monitoring and evaluation and its feedback to the on-going project is not conducted systematically as a part of the project. These are points to be paid attention to as lessons learned from the refinance scheme in formulating the JICA project.

In the field of technical assistance (TA), several projects such as KATARYST project, market-oriented SME assistance by USAID, and IFC's assistance targeting at financial institutions have been conducted. Regarding assistance relevant to loan business, IFC together with DFID supports Credit Information Bureau of BB to establish on-line credit information system (to be operated from June 2010) and training for financial institution to enhance appraisal capacities of SME loans. It is important to collaborate with other donors in the above mentioned fields.

5.2 SME Need for Assistance

In order to respond to SME need for assistance, it is important to collaborate with other donors and relevant domestic institutions providing TA as well as to build capacities of BB and participating financial institutions (PFIs).

6. Analyses on Effective Scheme of JICA Assistance

6.1 Background and rationale of undertaking the JICA assistance

In Bangladesh, the Government set a target to bring the country into a middle income country through the industrialization process by 2021. In this process, it is planned to increase Gross Investment from 24.2% of GDP in FY 2009 to 37.5% in FY 2021 and also increase the ratio of the manufacturing sector in the industry sector from 17.1% of GDP in FY 2009 to 30.0% in 2021. BB initiated to set up refinance schemes, etc. to extend financial supports to SMEs while short-term working capital loans in the trade sector account for a large portion of loans to SMEs. In the process of which demands on medium-and long-term loans for investment in equipment and facilities are expected to increase from now on, it is important to meet needs of financial institutions that supports SMEs.

6.2 Proposed Project Outline

(1) Project objective

The project is intended to contribute to filling-in of expected gaps of medium-and long-term loans for investment. Provision of stable medium-and long-term funds at a reasonable rate of interests together with the technical assistance is expected to provide banks and financial institutions with incentives to proactively identify prospective SMEs and extend investment loans to them

It is considered that the objective of the proposed project will possibly encompass the following factors:

1) to improve access for SMEs to finance;
2) to enhance investment of SMEs in the productive equipment and facilities;
3) to provide medium- and long-term finance through the PFIs;
4) to strengthen the capacity of the PFIs;
5) to strengthen the capacity of BB; and
6) to contribute to the improvement of the productivity of SMEs in Bangladesh.

(2) Proposed Implementing Arrangements

The Bank and Financial Institution Division of the Ministry of Finance (MOF) is expected to play the role of an executing agency. On the other hand, BB will act as the agent responsible for the implementation of the project and the management of funds under the administration agreement concluded between MOF and BB. A Project Implementation Unit (PIU) will be established at BB with a full-time Project Director and staff members who will specifically handle all relevant tasks related to the project, separately from the existing administrative structure. For the smooth implementation of the project within the framework of the SME promotion policy of the Government, a Steering Committee will be established with BFID being a chairperson and BB, Finance Division (FD) and Economic Relations Division (ERD) of MOF, Ministry of Industries (MOI), SME Foundation, a PFI, etc. being members. The Committee discusses and makes decisions on policy issues for the project such as approval and periodical review of the operating guidelines and accreditation criteria of PFIs, periodical reviews of the project, the establishment and amendment of terms and conditions of the sub loans and feedbacks of lessons learned from the practical experience of the project implementation into the policy formulation relating to issues like access to financing. The figure below shows the implementation arrangement of the proposed project.

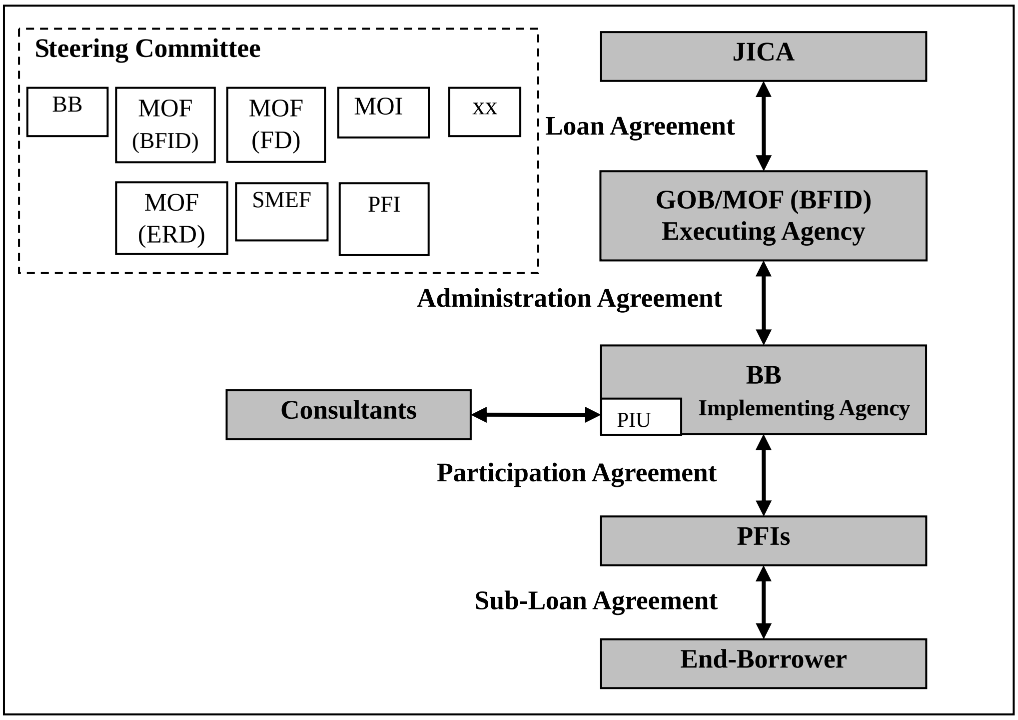


Figure 6: Implementing arrangements with agreements to be concluded among concerned parties

(3) Project cost

While it is difficult to estimate demand and supply gaps of medium-and long-term investment loans to SMEs, it is necessary to continue discussions with the Bangladeshi side and conduct further study on the appropriate size of the loan for implementation of the project. On the other hand, considering the outcome of the analysis in Chapter 4.7, it is estimated that a loan could range possibly from USD 30 million to USD 50 million. The table below shows the estimated project cost in case the amount of JICA ODA sub-loan portion is USD30 million. The total ODA loan is estimated at USD 33.0 million including employment of consultants (software development and capacity buildings).

Table 4: Estimated project cost (tentative)

USD million

Item	Amount
1. Sub-projects	40.0
JICA ODA sub-loans	30.0
PFIs' sub-loans	6.0
SME contributions	4.0

Item	Amount
2. Consultant (JICA ODA Loan)	3.0
3. Total Project Cost (1+2)	43.0
Out of which: ODA Loan portion	(33.0)

(4) Target group and sub-projects

The target beneficiaries of the proposed project will be SMEs that have growth potentials and needs and absorption capacities of investment loans ranging from Tk 0.5 million to Tk 50.0 million.

(5) Consulting services

It is considered that the consulting services will, among others, include the following tasks:

1) Assistance to BB in managing and controlling the project funds/revolving funds for SMEs, and improving monitoring and evaluation, and capacity building of BB.
2) Capacity building of PFIs (training courses on loan appraisal and supervision of long-term investment projects, strengthening of management in terms of issues such as maturity mismatches and NPLs)
3) Coordination with other technical cooperation agencies (donors as well as domestic institutions), and promotion of the project, etc.

(6) Social and Environmental Consideration

Under the proposed project, the former JBIC Environmental Guidelines (Japan Bank for International Cooperation Guidelines for Confirmation of Environmental and Social Considerations, April 2002) should be applied. The proposed project is designed to provide financing to financial intermediaries. Sub-projects can not be specified prior to JICA approval for financing, as they may have environmental impacts. Therefore, the project will be classified as Category FI under the former JBIC Environmental Guidelines. For a project classified as Category FI, JICA checks through the financial institutions to see whether the appropriate environmental and social considerations as stated in the Guidelines are ensured for sub-projects.

1. Outline of the Survey

1.1 Background of the Survey

The Bangladeshi economy has recorded a remarkable performance over recent years with about 6 percent annual growth, backed by brisk activities in the private sector. Such trends are expected to continue despite the severe financial crises affecting the whole world. In order to sustain the robust performance of the private economy, it is obvious that Small and Medium-sized Enterprises (SMEs) should play a critical role, given the presence of SMEs particularly in the industrial sectors. While statistics are limited, it is estimated that nearly 30 percent of the economic value added has been generated by SMEs. Moreover, accelerating the growth of SMEs will be vital for the creation of employment, given that 70 – 80 percent the non-agricultural labor force works for SMEs. Since the development of industry is the engine of economic growth and a potentially vital source of employment for a country with a large population like Bangladesh, it is especially vital to encourage SMEs in the industrial sector (e.g., manufacturing) to increase investment for establishing/ expanding production capacity.

With this in mind, the Government of Bangladesh (GOB) has been taking several initiatives to invigorate the potential of SMEs and nurture the enabling environment for them. These have included the establishment of an SME Foundation and the update of the new SME policy 2009 (still under process). Donors are also cognizant of the importance of this issue and have provided several forms of assistance.

Regarding the bottlenecks in further growth of SMEs in industry, it is generally considered that one of the most significant impediments is their limited access to finance from the formal banking system. In order to address this issue, GOB has made efforts to facilitate SME access to the banking sector through institutional measures and/or the creation of allocated financial channels especially for SMEs with the assistance of donors. While such efforts have contributed to an improvement, a majority of the financing needs of SMEs seem yet to be met, due to both structural impediments and the supply-demand gap in financing resources.

In view of the above, it is felt that further financial assistance for SMEs, mainly in the industrial sector (e.g., manufacturing), is highly expected, possibly with the combination with the technical assistance, aiming at improving the financial intermediation of the financial sector for SMEs. Thus, in order to improve financial intermediation, particularly for SME investment in industry, and thereby contributing to the development of the country's industry (especially, manufacturing) and job creation, Japan International Cooperation Agency (JICA) conducted a mission in Dhaka, Bangladesh, from 26th to 29th of July, 2009. This was to exchange views about various issues of private sector development and to discuss the Scope of Work (S/W) for the Preparatory Survey (the "Survey") as a basis for JICA's future involvement with private sector development.

1.2 Objective of the Survey

(1) To estimate the size of the demand-supply gap in SME financing, particularly in the industrial sector and for medium-and long-term loans; attention should be drawn to SMEs that might contribute to the promotion of export-oriented industry in the future, centering on the manufacturing sub-sector, and on SMEs that might serve to generate employment; the results of the study will be used as a basis for JICA's possible assistance in improving their access to finance.

(2) To identify the demand-side and supply-side "constraints" (institutional, capacity, procedural etc.) hindering SME smooth access to finance, and to make a pragmatic

recommendation for addressing this bottleneck.

(3) To propose an effective approach for JICA to provide assistance for the development of SMEs in the industrial sector by means of ODA loans. Also, to clarify the need for capacity development for the same purpose.

1.3 Terms of Reference of the Survey

Terms of Reference consist of the following three main items:

TOR 1: Basic survey (SME sector and policy as well as the financial sector and policy)

TOR 2: Analysis of justification of financial assistance for SMEs

TOR 3: Analysis of effective schemes of JICA assistance (implementation arrangements and schemes to enhance effectiveness)

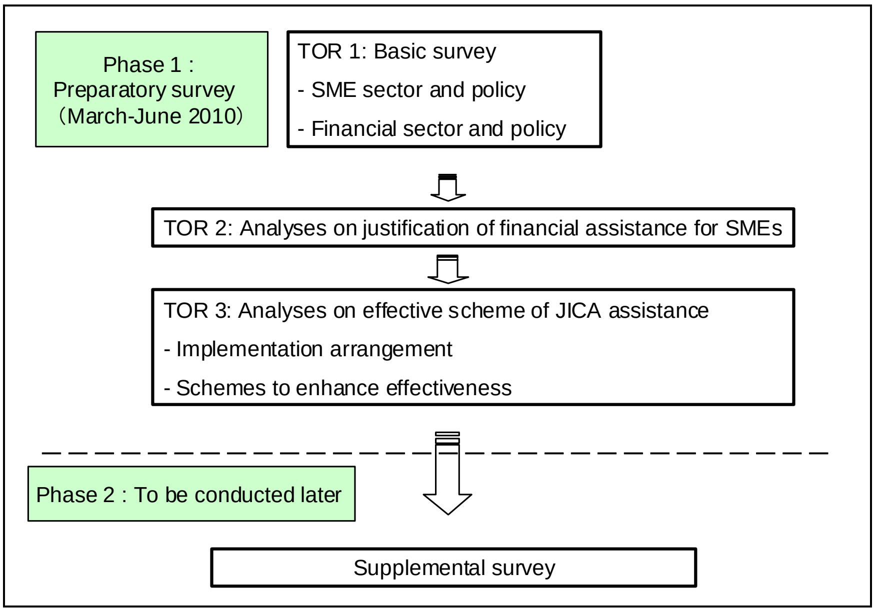


Figure 1-1: Relations among TORs and Phases

Under TOR 1, a basic survey will be conducted in order to grasp the overall characteristics of SMEs and their access to financing facilities. This basic survey will provide a basis to justify financial assistance for SMEs under TOR 2, where a supply-demand gap is estimated and the necessity for JICA assistance is clarified. Following the analyses of the justification for JICA assistance, effective schemes of assistance are studied in terms of the implementation arrangement and schemes under TOR 3. The outcome of TOR 3 will form a basis for the Implementation Plan (I/P). The preparation of the I/P will not take place during the first phase but in a subsequent phase of the preparatory survey.

The following sections provide detailed descriptions of each TOR and the survey methodologies to be applied.

<u>TOR1: Basic Study</u>

(SME-sector and Relevant Policy)

1-1. To review the latest situation of SMEs including an analysis on the impact on their performance of the recent global economic turmoil.

1-2. To conduct sub-sector analysis of SMEs, particularly within manufacturing industry, and of SMEs which are expected to contribute to employment generation, including an estimation of their potential demand for financing resources, highlighting the estimation of medium-and long-term loans.

1-3. To examine the latest GOB initiative(s) to invigorate SME activities and to increase the financing for SMEs.

(Financial Sector and Relevant Policy)

1-4. To review both the overall financial sector and the more detailed situation of finance for SMEs in Bangladesh. Also, to analyze the possible future impact of the recent global economic crisis on the financial sector, including its impact on the supply of financial resources to SMEs.

1-5. To examine and analyze lending conditions (real/nominal lending rates according to maturity, deposit rates, call rates etc.) according to the type/size of the borrower, and collateral requirements.

1-6. To examine the role of the Central Bank (Bangladesh Bank) in terms of SME financing.

1-7. To examine the roles and the latest situation of state-owned financial institutions relating to the development of SMEs.

1-8. To follow-up on the current progress of financial sector reform in Bangladesh.

1-9. To analyze policy issues related to SME finance, including the legal framework and documents that support SME finance.

<u>TOR2: Analyses of the Justification for Financial Assistance for SMEs</u>

2-1. To estimate the size of potential demands for finance for SMEs, according to the types of financing needs (short-term working capital, investment capital, etc.), industry and area.

2-2. To identify the bottlenecks that need to be tackled in order to improve financial intermediation for SMEs, especially those of the manufacturing industry and also those expected to contribute to employment generation.

2-3. To review and analyze the modality and impact of other donor assistance serving the same purpose, in order to clarify and justify the JICA assistance.

<u>TOR3: Analysis of the Effective Scheme of JICA Assistance</u>

(Implementation Arrangements)

3-1: To analyze possible project schemes to assist end-user SMEs.

3-2: To examine the role and capacity of the candidate executing agencies of GOB.

3-3. To analyze the administration of the “revolving fund” and responsibility for exchange-rate fluctuation risk.

3-4. To analyze the selection criteria of target end-users (beneficiaries) of the project.

3-5. To analyze the selection criteria of participating financial institutions (PFIs).

3-6. To analyze the procedures for loan application.

3-7. To analyze the appropriate terms and conditions within the project scheme.

(Schemes to Enhance Effectiveness)

3-8. To examine the necessity for consultancy services to manage and monitor the implementation of the project.

3-9. To identify and propose areas requiring further technical assistance, aimed at improving financial intermediation for SMEs (Japan’s comparative advantage would also be taken into consideration by stock-taking of past experiences.)

3-10. To analyze possible coordination with other government organizations and private sector parties.

3-11. To examine the necessary social and environmental considerations of sub-projects.

1.4 JICA Survey Team

The following JICA Survey Team (JST) consisting of OPMAC experts is engaged in this Survey.

Name	Title	Responsibility
Mr. Tomoo Mochida	Team Leader/ SME Finance	To analyze the Effective Scheme of JICA Assistance and the financial sector for the SME sector in Bangladesh
Mr. Yasuhisa Kuroda	Financial market Analyst	To analyze the financial sector in Bangladesh
Ms. Naomi Murayama	Macro-economy / Donor assistance Analyst	To analyze the macro-economy and the financial sector for SMEs and other donor activities in Bangladesh

1.5 Survey schedule

The schedule of the Survey is shown as follows:

(1) Commencement of the Survey : February 19, 2010
(2) Preparatory work : February 19 to March 5, 2010
(3) Inception Report : Beginning of March 2010
(4) 1st visit by JST : from March 6 to April 4, 2010
(5) Progress Report : End of April 2010
(6) 2nd visit by JST : May 1 to May 20, 2010
(7) Draft Final Report : Beginning of June 2010
(8) 3rd visit by JST : June 19 to June 23, 2010
(9) Completion of Final Report : July 12, 2010

The final report shall be submitted from JST to JICA by the end of June 2010.

The list of organizations that JST visited during the survey in Bangladesh has been shown in Table 1-1. Figure 1-2 shows the overall work flow of the survey.

1.6 Survey Area

Survey areas have been selected in order to examine SME activities and/or their financing needs. Dhaka, Sylhet, Bogra and Khulna/Jessore have been chosen as sites for Survey visits by consultants.

Table 1-1: List of organizations/departments visited during the Survey period

1. Bangladesh Bank	
	Agricultural Credit and Special Programs Department
	Banking Regulation and Policy Department
	Credit Information Bureau (CIB)
	Department of Banking Inspection 1 and 2 (DBI-1, DBI-2)
	Dept of Off-site Supervision
	Department of Financial Institutions and Markets (DFIM)
	Equity and Entrepreneurship Fund Unit (EEF)
	Investment Promotion & Financing Facility Project Cell
	Law Department
	Policy Analysis Unit
	SME & Special Programs Department
	BB Training Academy (BBTA)
	Banking Statistics Division, Statistics Department
2. Government /relevant agencies	
	Planning Commission
	MOF
	Finance Division
	Banking and Financial Institution Division
	Economic Relations Division
	MOI
	Additional Secretary, Deputy Secretary (SME)
	SME Foundation (SMEF)
	BBS
	Microfinance Regulatory Authority (MRA)
3. Financial Institutions	
	SCBs (Sonali, Agrani, Rupali, Janata)
	SBs (Basic)
	PCBs (Southeast, Pupali, Uttara, Eastern, Mutual Trust, Brac, Dhaka, Trust, Jamuna, Prime)
	MIDAS
4. Supporting organizations and associations	
	Bangladesh Engineering Industry Owners’ Association (BEIOA)
	Bangladesh Small and Cottage Industries Corporation (BSCIC)
	Dhaka Chamber of Commerce and Industry (DCCI)
	The Federation of Bangladesh Chamber of Commerce and Industry (FBCCI)
	Bangladesh Enterprise Institute (BEI)
5. Donors/international organizations	
	IMF
	Intermediary loans
	Asian Development Bank
	The World Bank
	Technical Assistance
	KATARYST Project
	IFC
	IFC-BICF
	IFC-SEDF
	USAID-PRICE
	EU-INSPIRED
6. SMEs	

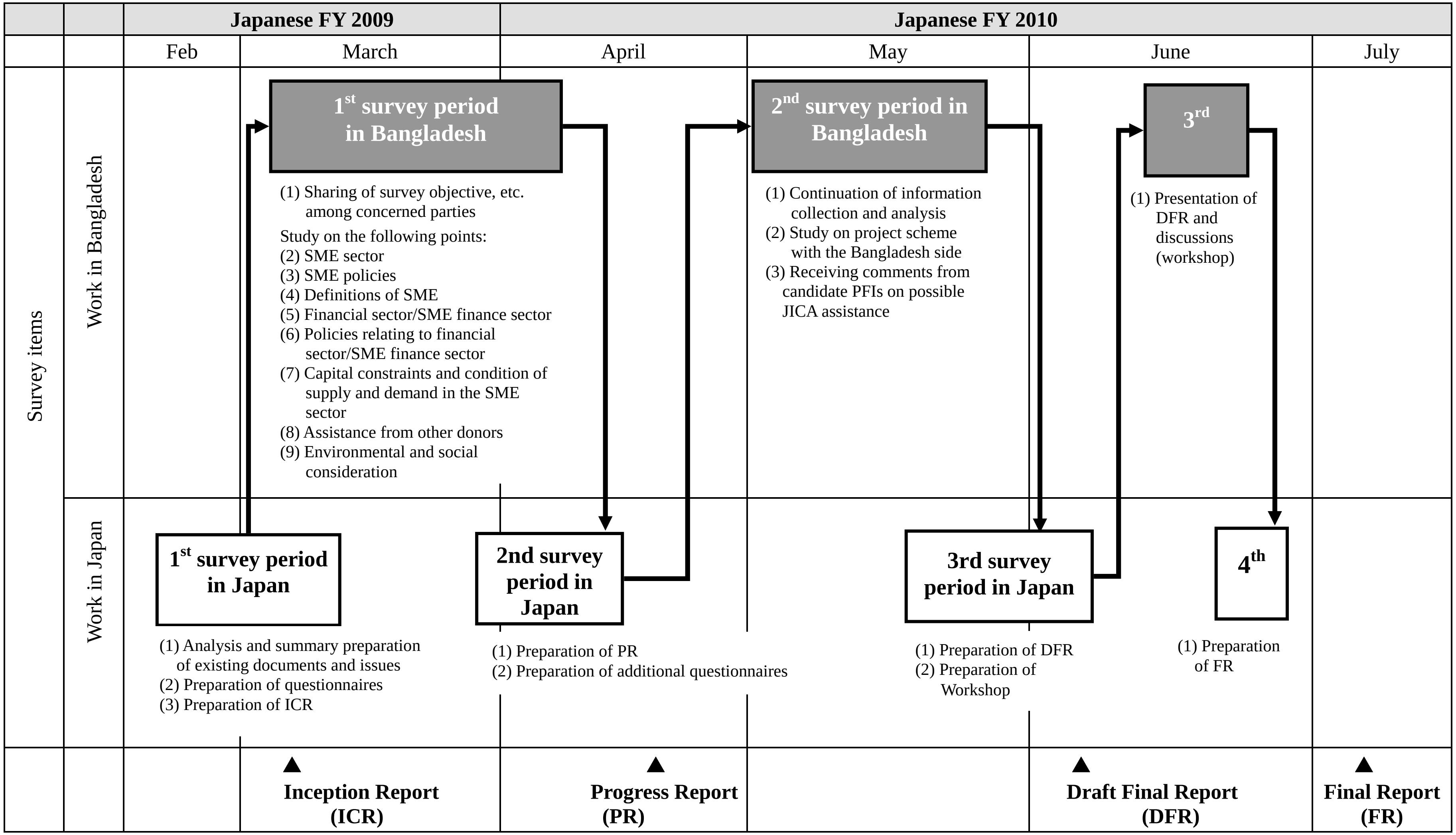


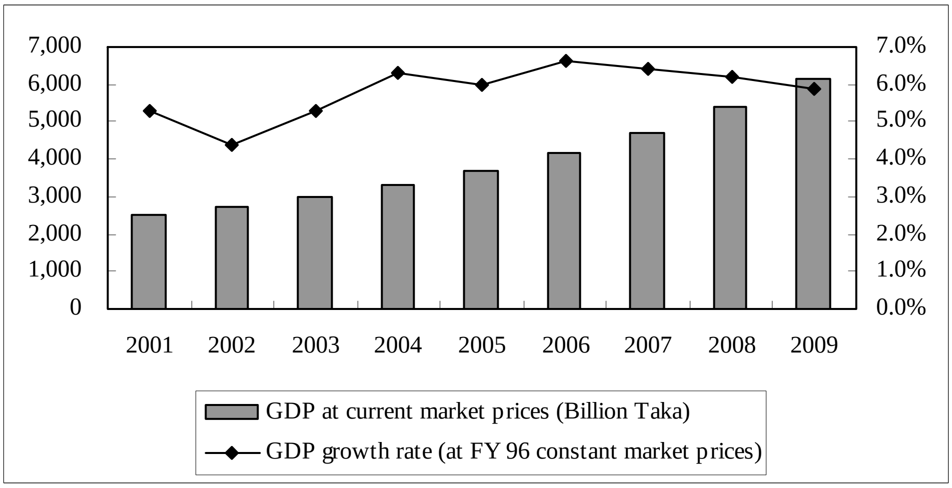
Figure 1-2: Work Flow

2. Economy and Relevant Policies

2.1 Macro-economic situation

2.1.1 Economic Development Trends

Bangladesh has achieved a high growth rate during recent years. The average GDP growth rate from FY00 to FY09 was 5.83% and statistics show around a six percent growth since FY04 (Figure 2-1).



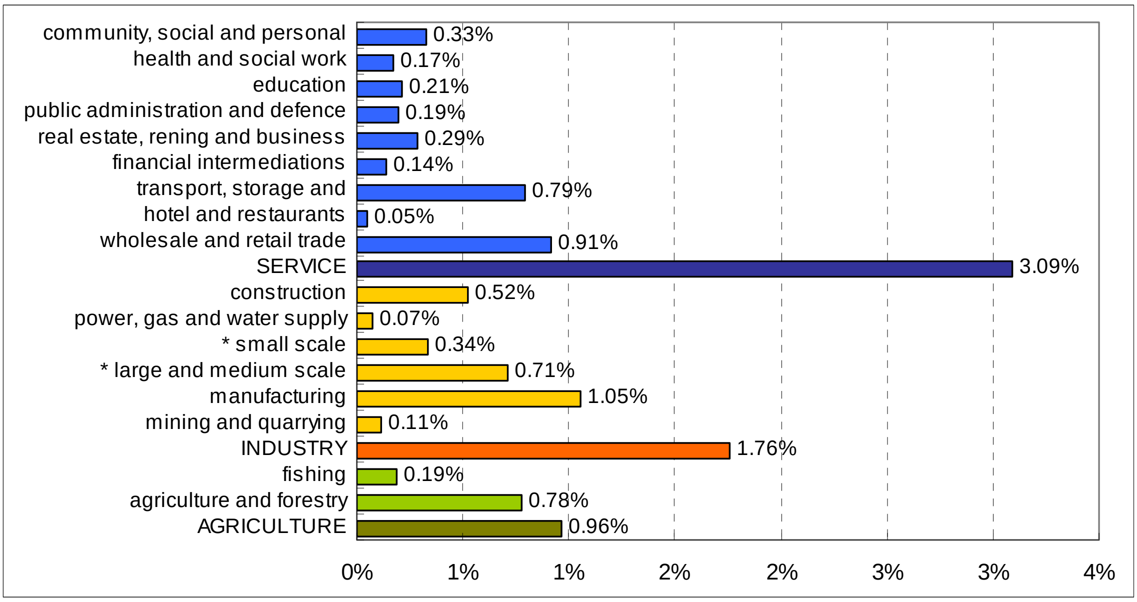
Source: Bangladesh Bank, Annual Report 2008-2009
Note: Figures on FY09 are provisional.

Figure 2-1: Trends of GDP (current market price) and growth rates

This is recently highly appreciated globally: in 2005, Bangladesh was selected as one of the countries with the potential to affect the world economy, called the "Next 11"[1], by Goldman Sachs. Despite the world economic crisis and domestic destabilizing factors such as shortages of electrical power and gas, Bangladesh has kept a high growth rate. The main engines for this high economic growth are development of the service sector, especially the wholesale and retail trade sector (Figure 2-2, Table 2-1).

The growth trend is expected to continue. In the Monetary Policy Statement for the first half FY10, announced in July 2009 by the Bangladesh Bank, in FY 10, real GDP growth was projected at 5.5 – 6.0 percent.

[1] The Next 11 is a concept introduced by Goldman Sachs late in 2005 with the purpose of identifying the eleven countries, Bangladesh, Egypt, Indonesia, Iran, Korea, Mexico, Nigeria, Pakistan, Philippines, Turkey and Vietnam, as countries that potentially have a BRIC-like impact in rivaling the G7.



Source: Calculated on the basis of statistics of Bangladesh Bank, Annual Report 2008-2009
Note: Figures are provisional.

Figure 2-2: contribution to GDP growth by sub-sectors

Table 2-1: Trend of contribution to GDP growth by major sectors

Unit: %

Items	FY04	FY05	FY06	FY07	FY08	FY09
AGRICULTURE	0.96	0.51	1.10	1.00	0.69	0.96
INDUSTRY	2.07	2.29	2.76	2.43	1.99	1.76
manufacturing	1.13	1.32	1.78	1.66	1.27	1.05
* large and medium scale	0.78	0.95	1.33	1.18	0.91	0.71
* small scale	0.35	0.38	0.45	0.48	0.36	0.34
construction	0.71	0.73	0.75	0.64	0.52	0.52
SERVICE	2.79	3.14	3.16	3.40	3.19	3.09
wholesale and retail trade	0.91	0.99	0.95	1.13	0.97	0.91
transport, storage and communication	0.61	0.77	0.80	0.81	0.87	0.79
financial intermediations	0.11	0.15	0.14	0.16	0.16	0.14
Total	5.82	5.94	7.02	6.83	5.87	5.82

Source: Calculated on the basis of statistics of Bangladesh Bank, Annual Report 2008-2009
Note: Figures of FY 2009 are provisional.

The IMF[2] projects that the real GDP will grow at 5.0 % p.a. in FY 2010, slightly lower than the BB projection, but that the growth rate will go up to 5.8% in FY 2011 and 6.0% thereafter until FY 2014. In the Outline Perspective Plan of Bangladesh 2010-2021 drafted by the Planning Commission in March 2010, the target of real GDP growth is set as 8.0 % for 2015 and 10.0 % for 2021. The IMF also projects that the real GDP growth rate could increase to 8.0 % by FY

[2] IMF, Bangladesh: 2009 Article IV Consultation – Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion, February 2010.

2014 under the reform scenario where tax revenue is raised to the level envisaged in and the implementation ratio of the Annual Development Programme (ADP) is increased (IMF 2010, Ibid.).

Table 2-2: Major Macro-economic Indicator: FY 2001 to FY 2009

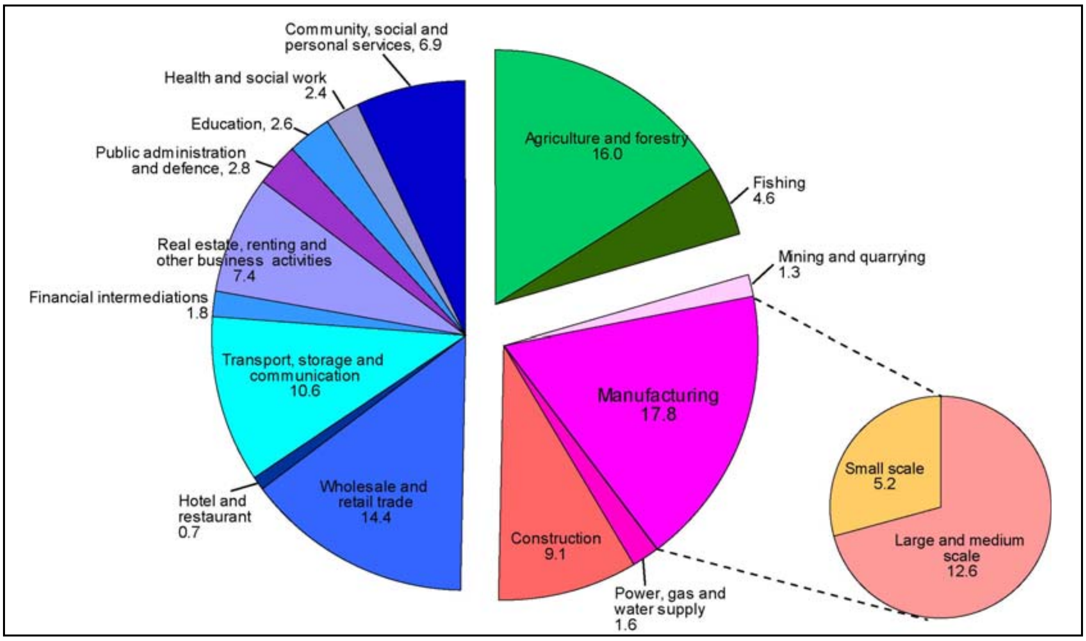
	2001	2002	2003	2004	2005	2006	2007	2008	2009
GDP at current market prices (Billion Taka)	2535.0	2732.0	3005.0	3330.0	3707.1	4157.3	4724.8	5419.2	6149.4
GDP growth rate (at FY 96 constant market prices)	5.3%	4.4%	5.3%	6.3%	6.0%	6.6%	6.4%	6.2%	5.9%
Per capita GDP in Taka (at current market prices)	19525.0	20754.0	22530.0	24628.0	27061.0	29955.0	33607.0	38330.0	42638.0
CPI Inflation rate (Base: FY96=100)	1.9	2.8	4.4	5.8	6.5	7.2	7.2	9.9	6.7
Balance of Payments (USD million)									
Exports fob	6419.0	5929.0	6492.0	7521.0	8573.0	10412.0	12053.0	14151.0	15583.0
Imports fob	-8430	-7697	-8707	-9840	-11870	-13301	-15511	-19481	-20291
Trade Balance	-2011.0	-1768.0	-2215.0	-2319.0	-3297.0	-2889.0	-3458.0	-5330.0	-4708.0
Remittances	1882.0	2501.0	3062.0	3372.0	3848.3	4801.9	5978.5	7914.8	9689.3
Current Account balance	-1018.0	157.0	176.0	176.0	-557.0	924.0	936.0	702.0	2536.0
External Indebtedness									
Total outstanding of external debt (public sector) (USD million)		16276.0	16455.0	16761.0	19286.0	19420.0	20713.0	21294.0	
Central Government Operations (Billion Taka)									
Total revenue	228.4	276.8	309.7	339.0	392.0	448.7	494.7	605.4	691.8
Grants			24.5	26.6	26.4	24.8	21.5	43.9	49.3
Total expenditure	374.5	389.9	411.4	441.6	556.3	610.6	668.4	936.1	941.4
Money Supply (M2) (Billion Taka)	871.7	986.2	1139.9	1297.2	1514.4	1806.7	2115.0	2487.9	2964.9
M2 percent of GDP at current market prices	34.4	36.1	37.9	39.0	40.9	43.6	44.9	45.6	48.2
Excess Liquidity (in billions of taka)	40.0	62.0	75.0	113.0	87.0	80.0	142.79	129.88	n.a
Exchange Rates (Taka per USD)	54.0	57.4	57.9	58.9	61.4	67.1	69.0	68.6	68.8
Foreign Exchange Reserve (USD million)	1307.0	1583.0	2470.0	2705.0	2930.0	3484.0	5077.0	6149.0	7471.0

Source: Bangladesh Bank, Annual Report 2008-2009, MOF, Bangladesh Economic Review 2009 Bangladesh Bank, Major Economic Indicators: Monthly Update, September 2009, IMF, Bangladesh Statistical Appendix, 2007

2.1.2 Economic structure and employment

This section analyzes the economic structure of Bangladesh from the viewpoint of GDP and employment.

With regard to the real GDP in 2009, the share of the agriculture and fishing sector was 20.6%, the industrial sector was 29.7% and the service sector was 49.7% (Figure 2-3). Tertiary industries account for about half of GDP. The share of the following subsectors are large; crops and horticulture (11.6%), manufacturing (17.8%), wholesale and retail trade (14.4%) and transport, storage and communication (10.6%).



Source: Bangladesh Bank, Annual Report 2008-2009
Note: Figures are provisional.

Figure 2-3: Sector share of GDP

The manufacturing sector has the largest share of GDP among all subsectors, and in particular, production by large and medium scale enterprises accounts for more than 70% out of total production in the manufacturing sector.

The industrial structure by share of employed labor force is presented in Table 2-3. The labor force in the agriculture, forestry and fisheries sector accounts for about half of the total labor force. Its share in FY 2005/06 decreased from FY 2002/03, but it still remained the largest source of employment. This is followed by the service sector, which accounted for 37.34% in FY 2005/06. The sub-sector of trade, hotel and restaurants employs about half of the labor force in the service sector. The share of the industrial sector is relatively small, but it showed a steady growth over the period. The labor force in the manufacturing sector is about 10 % out of the total labor force.

Table 2-3: Share of employed labor force (aged above 15 years) by sector

Sector	FY 1999/00	FY 2002/03	FY 2005/06
Total Population (million)	128.1	133.4	138.8
Labor force	40.7	46.3	49.5
(Annual growth rate of labor force)		4.4%	2.3%
Employment (million)	39.0	44.3	47.4
(Annual growth rate of employment)		4.3%	2.3%
Out of Employment: (%)			
Agriculture	**50.77**	**51.69**	**48.10**
Industry	**13.08**	**13.56**	**14.55**
- Manufacturing	9.49	9.71	10.97
Services	**36.16**	**34.75**	**37.34**
- Trade, Hotel and Restaurants	15.64	15.34	16.45
- Transport, Storage and Communication	6.41	6.77	8.44
- Community and personal services	13.08	5.64	5.49

Source: Bangladesh Ministry of Finance, Bangladesh Economic Review 2009, statistics on labor force and employment are quoted from the Policy Paper 0806 of BB titled “A Note on the Contribution of Small and Medium Enterprise to GDP in Bangladesh,” June 2008.
Note: Population aged above 15 years of age has been counted as labor force in the figures for 2002/03 and 2005/06, but for the figures for FY 1999/00 the criterion for counting the labor force was the population above 10 years.

The table also compares growth rates of labor force and employment. During the period from 1986 to 2006, the labor force grew at 2.90% while the employment did at 2.61% (Policy Paper 0806 of BB in 2008). During the period from FY 1999/00 to FY 2005/06, 1.47 million of the labor force was added every year while 1.40 million of employment was generated annually.

2.2 Government sector

2.2.1 Characteristics of Public Finance in Bangladesh

Although public finance in Bangladesh is characterized by persistent deficits (4.1% of GDP in case of FY 2009), it maintains the sustainable level. Tax revenue has been modestly increasing. Regarding expenditure, the development budget has been constantly underspent and the non-development expenditure has occupied more than 50% of the total expenditure. The fiscal deficits have been financed by foreign aid and international and domestic bank/non-bank borrowing[3]. While domestic bank borrowing (net) has continued to increase since 2005, as shown in Table 2-4, the non-bank borrowing (net) remained, varying from Tk 20 to 40 billion.

(1) Revenue
Tax revenue has been hovering at around 80% of total revenue.[4] Tax revenues include import duties, value added tax (VAT) and income tax. The collection of import duties in FY 2008-09 fell short of target as it was determined on the basis of prices of imported goods that experienced a fall under the global economic crisis. The revenue/GDP ratio has been rising slightly during the recent few years.

[3] Non-bank borrowing consists of non-cash bonds and high-cost National Savings Certificates (NSC).
[4] MOF, Bangladesh Economic Review 2009.
http://www.mof.gov.bd/en/index.php?option=com_content&view=article&id=71&Itemid=1.

Table 2-4: Development of Government Budgetary Operation

Unit: Billion Taka

Fiscal Year	2005	2006	2007	2008	2009	2010 (Budget)
Total revenue	392.0	448.7	494.7	605.4	691.8	794.6
- tax revenue	319.5	361.8	392.5	480.1	555.3	639.6
- tax /total (%)	81.5%	80.6%	79.3%	79.3%	80.3%	80.5%
Foreign grants	26.4	24.8	21.5	43.9	49.3	51.3
Total expenditure	556.3	610.6	668.4	936.1	941.4	1138.2
- NDRE (Note)	315.9	348.1	420.6	522.5	626.8	695.0
- ADP (Note)	205.0	215.0	216.0	225.0	230.0	305.0
(Utilization ratio of ADP (%))	91.6%	91.0%	83.0%	82.0%	85.7%	NA
Overall deficit (excluding grants)	164.3	161.9	173.7	330.7	249.6	343.6
Overall deficit (including grants)	137.9	137.1	152.2	286.8	200.3	292.3
Financing	137.9	137.1	152.1	286.8	200.3	292.3
- foreign borrowing (net)	61.9	55.7	51.8	87.6	58.3	86.7
- domestic bank borrowing (net)	36.0	49.1	65.3	104.0	107.0	167.6
- non-bank borrowing (net)	40.0	32.3	35.0	20.0	35.0	38.0
GDP (at current market prices)	3707.1	4157.3	4724.8	5419.2	6149.4	6867.3
Revenue (% of GDP)	10.6%	10.8%	10.5%	11.2%	11.2%	11.6%
Expenditure (% of GDP)	15.0%	14.7%	14.1%	17.3%	15.3%	16.6%
Deficit (% of GDP)	4.4%	3.9%	3.7%	6.1%	4.1%	5.0%

Source: Bangladesh Bank, Annual Report 2008-2009, MOF, Bangladesh Economic Review 2008.

Note 1: NDRE stands for non-development revenue expenditure and ADP stands for annual development programme

Note 2: A total of domestic borrowing (net) in FY 2008 was Tk 199.2 billion although domestic bank borrowing and non-bank borrowing do not sum up with the amount.

(2) Expenditure

Turning to the expenditure side, the ADP accounts for about 30% of the total expenditure. Utilization of the ADP was about 83% in FY 2007 and about 82% in FY 2008. The provisional utilization ratio in FY 2009 was about 86%. The non-development expenditure accounts for about 60% of the total expenditure. Although the government has made an effort towards the privatization of state-owned companies, it has not seen great improvements in expenditure due to the implementation of the public sector wage increase with retrospective effect, and increase in safety net expenditures. Moreover, the share of interest payments on foreign and domestic loans out of the total non-development expenditure is around 20%. The overall deficit has been around 5 % in terms of GDP and the expenditure/GDP ratio has not been improved. In composition of domestic debt, treasury bills and treasury bonds, which are mostly held by domestic commercial banks, accounts for 39% out of the total at the end of FY 2009, National Savings Certificates (NSC), which are mostly held by the non-bank private sector, for 38%, and others, including overdrafts from BB for 23%. Relatively large part of funds of domestic financial sector is channeled into investment in treasury bills and NSC. NSC sales in FY2010 are going strong thanks to the higher interest rates than deposit rates and results in Tk 52 billion non-bank borrowing (the target for the yeas was Tk 38 billion). According to the World Bank, increasing of non-banking borrowing through NSC and foreign financing results in creation of the “space for growth of bank credit to the private sector”. However, the World Bank also points out that the rise in the share of non-bank domestic borrowing means an impending increase in interest payment on domestic debt.[5]

[5] WB, Bangladesh Economic Update, April, 2010

2.3 Recent Economic Situation in Bangladesh

2.3.1 World Economic Crisis and its effects

During FY 2009, the Bangladeshi economy attained 5.9% real GDP growth, and was only mildly impacted by the ongoing global slowdown because of limited openness and strengthened domestic demand. Increased domestic production in crops and the resilience of the service sector helped the real economy to remain steady. Economic growth was also aided by growth in exports and buoyant inflows of workers' remittances. The country's external current account balance continued to record a significant surplus supported by these factors, and they were more than sufficient to offset the trade and service deficits.

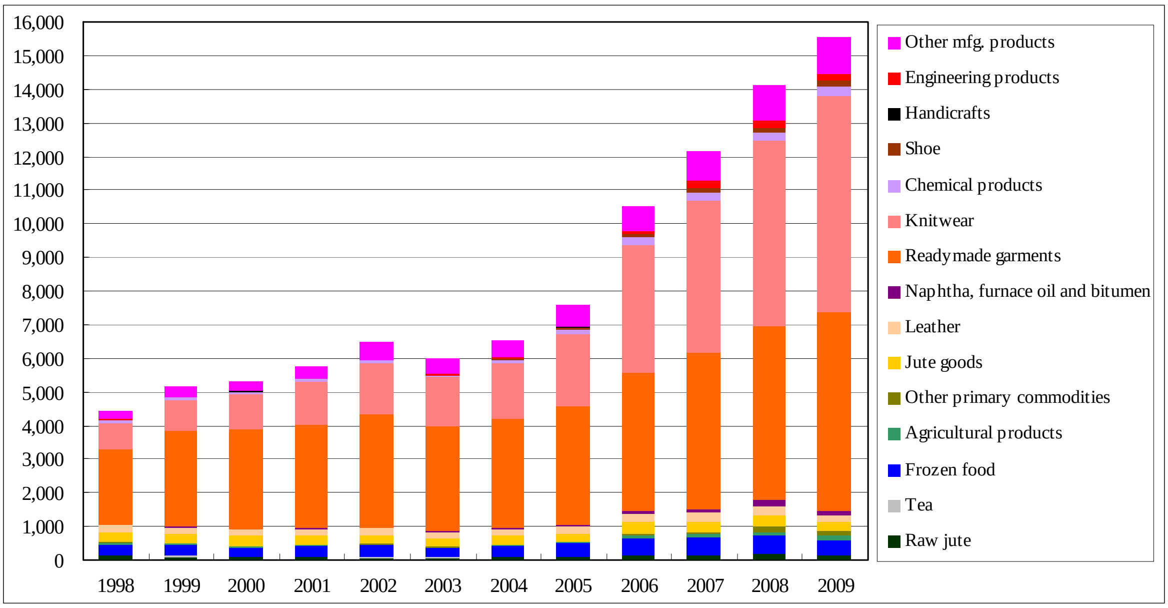
The 5.9 percent real GDP growth in FY 2009 was underpinned, on the supply side, by strongly performed growth in the agriculture and services sector, while growth in the industrial sector slowed, mainly due to a weakening in export demand. The industrial sector grew by 5.9% in FY 2009, lower than the 6.8% of FY 2008. The growth in the manufacturing sub-sector weakened significantly, from 7.2% in FY 2008 to 5.9% in FY 2009.

The World Economic Crisis is unlikely to have a significant impact on Bangladesh economy. However, recent statistics reveal an impact on the country's economy in terms of external trade, the number of Bangladeshi overseas workers and foreign direct investment (FDI). The following section reviews the impact of the crisis, together with the past trend in these respective areas.

(1) External trade

The trend of exports in the last decade shown in Figure 2-4 illustrates especially that knitwear has grown more than seven-fold and contributes greatly to the growth of the total exports value. Although the value of exports has been growing for the last ten years (Table 2-2), the trade balance is still negative as exports from Bangladesh depend on imported goods.

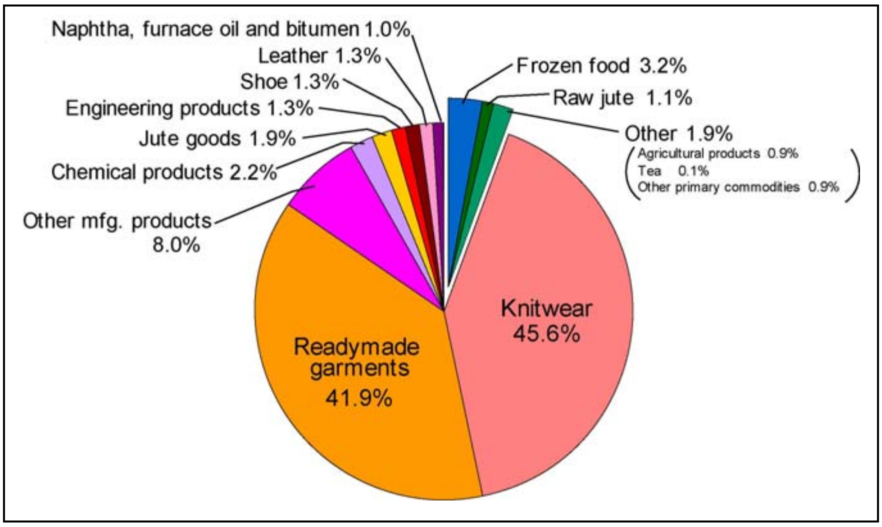
Unit: million USD



Source: Bangladesh Ministry of Finance, Bangladesh Economic Review 2009

Figure 2-4: Trend of exports value by major commodities

By reviewing the value of exports by major commodities in FY2008 (Figure 2-5), two sectors, readymade garments and knitwear, account for 76% (USD 10,700 million) of total exports (USD 14,111 million).



Source: Bangladesh Ministry of Finance, Bangladesh Economic Review 2009

Figure 2-5: Value of exports by major commodities

The following table shows the top 11 countries to which the country exported commodities in FY 2007-08 and FY 2008-09. As seen from the table, the top trade partner was the USA followed by countries in Western Europe and Canada. The total export value of 11 countries accounts for about 82% of the total and the share of knitwear and woven garments in these 11 countries reached as high as 87.2%. The exports of Bangladesh are highly dependent on markets for knitwear and woven garments in North America and in European countries.

Table 2-5: Major countries for export commodities in FY 2007-08 and FY 2008-09

USD million

No	Country	FY 2007-2008		FY 2008-2009		
		Export value	Share of country	Export value	Share of country	Share of Knitwear/woven garments in each country
1	U.S.A	3,591	25.4%	4,052	26.0%	91.1%
2	Germany	2,175	15.4%	2,270	14.6%	94.1%
3	U.K	1,374	9.7%	1,501	9.6%	81.5%
4	France	953	6.8%	1,031	6.6%	94.1%
5	Netherlands	654	4.6%	971	6.2%	93.5%
6	Canada	533	3.8%	663	4.3%	88.5%
7	Italy	579	4.1%	616	4.0%	84.9%
8	Spain	598	4.2%	601	3.9%	90.9%
9	Belgium	488	3.5%	410	2.6%	61.6%
10	Turkey	238	1.7%	332	2.1%	72.2%
11	India	358	2.5%	277	1.8%	4.0%
Sub-total of 1-11		11,541	81.8%	12,735	81.8%	87.2%
Grand Total		14,111		15,565		79.3%

Source: Export promotion bureau, Country-wise export of commodities by broad description from Bangladesh during the period July-June, 2008-2009 (www.epb.gov.bd/)

Export earnings achieved a low, but still double digits, growth in FY 2009 as the global recession affected shipments mainly in the second half of FY 2009. The resilience of exports can be also explained by the strength of Bangladeshi products in the lower market segment (IMF 2010, ibid.).

Table 2-6: Export targets and performance

Unit: million USD

Products	Export performance for 08-09	Export target for 09-10	Strategic export target for July-Dec. 09-10	Export performance for July-Dec. 09-10	(4)-(3)	Export performance for July-Dec. 08-09	(6)-(4)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
All products	15,565	17,600	8,499	7,274	-1,225	7,755	-481
Out of which:							
Knitwear (A)	6,429	7,297	3,524	3,008	-516	3,241	-233
Woven garments (B)	5,919	6,688	3,230	2,583	-647	2,806	-223
(A) + (B)	12,348	13,985	6,753	5,591	-1,163	6,046	-456

Source: Export Promotion Bureau, Export performance for the Month of July – December 2009-2010

The export target for FY2010 is set at USD 17,600 million, about a 13% increase over the previous year's target of USD 15,500 million. Statistical data on exports from July to December 2009 illustrates the performance during this period. The actual result for all products was USD 7,274 million against the target of USD 8,499 million. This was below the level for the same period last year (Table 2-6). It can be pointed out that declines in the export performance of the knitwear and woven garment sector became a major factor in shrinking the total amount of exports. On the other hand, however, some non-RMG exports showed a sign of recovery.[6] The rising demand for raw jute and jute goods is reflected in the performance of exports in the first half of FY 2010, which exceeded targets during the corresponding period. In addition, the shortage of energy supply is a domestic factor that has been posing downside risks to export performance.

Table 2-2 on Page 2-4 shows trend of imports (FOB) over the last nine years and Table 2-7 below shows the composition of merchandise imports from FY 2006-2007 to FY 2008-2009. As seen from the table below, Bangladesh imports petroleum products and capital machinery. The garment industry depends on imported raw materials for production.[7]

In FY 2009, import values showed a lower growth rate (4.2%). This was mainly attributable to the lower prices of fuel oil and commodities in the international market and to decreased imports of grains due to a good domestic harvest. It can also be noted that the value of imported capital machinery showed a decreasing trend from FY 2007 to FY 2009.

[6] The World Bank, Bangladesh Economic Update, April 2010.

[7] The garment industry has also faced a freer world market following the expiry of the global Agreement on Textiles and Clothing (the World Trade Organization textile trade quota system) at end of 2004 (EIU, Country Profile 2008: Bangladesh, 2008).

Table 2-7: Composition of merchandise imports

USD million

Item	FY 2006/07	FY 2007/08	FY 2008/09	Share in FY 2009
Food grains	581	1,411	882	3.9%
Rice	180	874	239	1.1%
Other food items	1,337	2,082	1,829	8.1%
Consumer and intermediate goods	7,781	9,616	10,283	45.7%
Crude petroleum	524	695	584	2.6%
Petroleum products	1,709	2,058	1,997	8.9%
Raw cotton	859	1,213	1,291	5.7%
Yarn	582	691	792	3.5%
Textiles & articles thereof	1,892	1,892	2,099	9.3%
Capital goods and others	6,314	7,226	8,211	36.5%
Capital machinery	1,929	1,664	1,420	6.3%
Imports by EPZ	1,144	1,294	1,302	5.8%
Total import CIF	17,157	21,629	22,507	100.0%
Less freight & others	1,646	2,148	2,216	
Total import FOB	15,511	19,481	20,291	
Annual growth rate	16.6%	25.6%	4.2%	

Source: BB, Annual Report 2008-2009

The following table shows the top trading partners of Bangladesh in FY 2007-2008. China is listed on top, followed by India.

Table 2-8: Top trading partner - import (goods), 2007-2008

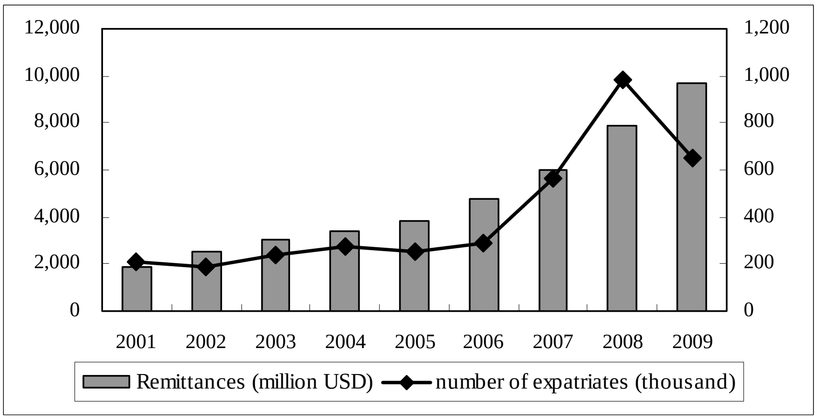
Country	Share
China	18.0%
India	13.8%
Kuwait	5.8%
Indonesia	5.6%
Japan	4.8%
Rep. of Korea	3.6%
USA	3.5%
Malaysia	3.3%
Thailand	3.1%
Uzbekistan	3.0%

Source: BBS, Foreign Trade Statistics, Nov 2009

(2) Overseas workers and their remittances

The number of Bangladeshi overseas workers has been dramatically increasing since 2006 as has been the amount of inward remittances from them. As a large number of workers from Bangladesh head for the Middle East for employment, the economic conditions of this region, which depend on petroleum, seem to have impact on the volume of remittances and the number of overseas workers who are destined for the Middle East.

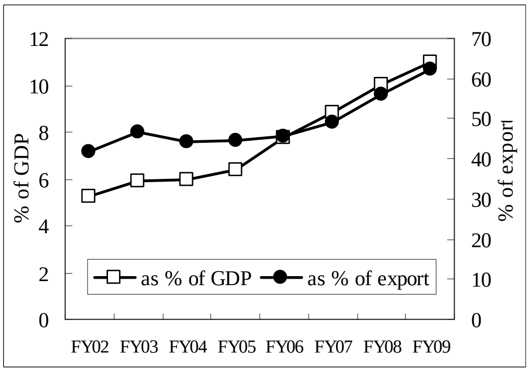
According to the *Bangladesh Economic Review 2009 (MOF)*, “manpower export” has been promoted by the government and it contributes to the economic development of the country through the generation of income and employment opportunities, and the bolstering of foreign exchange reserves. The number of overseas workers peaked at 981,102 in FY 2008 and workers’ remittances peaked at USD 9,689 million in FY 2009, respectively. Figure 2-6 shows this exponential increase of overseas workers and the remittances from them.

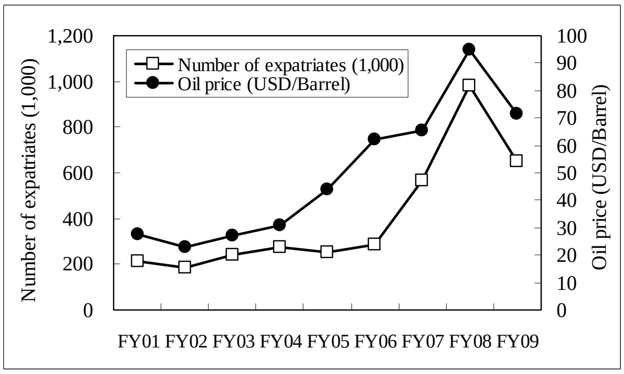


Source: Bangladesh Bank, Monthly Economic Trends, March 2010
Note: The number of overseas workers means the number of persons left for abroad on employment in respective fiscal years.

Figure 2-6: Trends of Inward Remittances and the number of overseas workers

Figure 2-7 below (Left) shows remittances in terms of GDP and export incomes from FY 2002 to FY 2009. In FY 2009, remittances as a percentage of GDP passed 10% and those as a percentage of exports were more than 60%. From these figures, it is understandable that workers’ remittances occupy a significantly important position in the Bangladeshi economy.





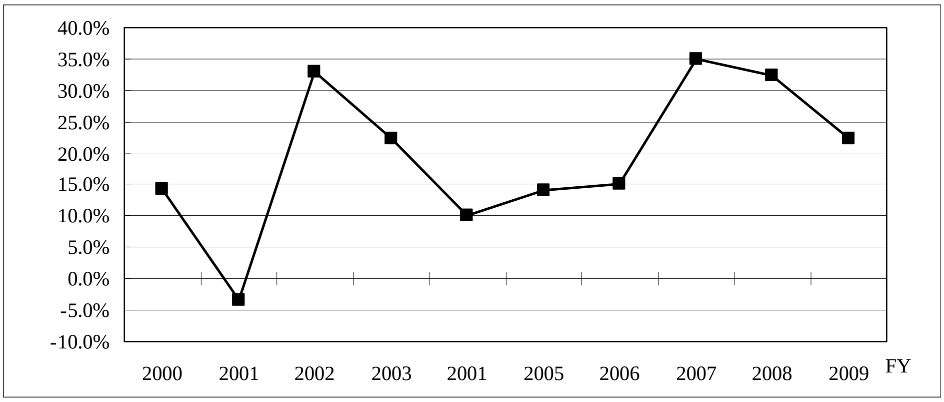
Source: Bangladesh Ministry of Finance, Bangladesh Economic Review 2009, Average of Weekly Abu Dhabi Murban Spot Price FOB (Dollars per Barrel) for oil prices (Figure on the right)

Figure 2-7: Remittances as percent of GDP and exports

Figure 2-8: Number of overseas workers and crude oil prices

Figure 2-8 (Right) shows the relation between the number of overseas workers and the level of oil prices over the same period. As many workers find their destinations in the Middle East, the trend of oil prices is very relevant to the number of workers who left for employment abroad.

The amount of inward remittances has shown an upward trend in the last decade. The average annual growth rate during this period was 19.5%. Since 2002, the growth rate has consistently maintained positive. However, it can be noted that the average annual growth rate has demonstrated a downward trend since FY 2007 (Figure 2-9) and the number of overseas workers in FY 2009 has declined compared with the previous fiscal year. The number of overseas workers for the first 6 months of FY 2010 is 224,000, about a 50% decrease over the previous year (399,000).



Source: Bangladesh Bank, Monthly Economic Trends, March 2010

Figure 2-9: Trends of the average annual growth rate of inward remittances

According to ADB[8], about 72,000 jobless Bangladeshi overseas workers returned home in 2009, a 33.0% rise from 2008. In 2009, about 23,000 Bangladeshi workers returned from Saudi Arabia alone, the largest market for Bangladeshi workers. Statistics on inward remittances by country signal a new trend in Bangladeshi workers heading for Asian countries (Table 2-9).

Table 2-9: Annual growth rate of inward remittances for the last three years

Major countries	% of total amount of remittances in FY2009	Growth rate (%)			
		FY 2007	FY 2008	FY 2009	FY 2010 (Jul-Dec)
Middle East					
Saudi Arabia	29.5	11.0	34.0	23.0	24.8
UAE	18.1	57.0	41.0	54.6	28.0
Kuwait	10.0	49.8	26.9	12.4	4.7
Qatar	3.5	44.4	24.3	18.5	13.6
Oman	3.0	28.4	12.3	31.5	34.1
Developed countries					
USA	16.3	32.6	48.3	14.1	-7.7
UK	8.2	71.4	1.0	-11.9	18.0
Italy	1.9	90.8	43.3	-12.9	22.3
Japan	0.2	16.8	60.2	-13.3	6.2
Others					
Singapore	1.7	30.9	62.2	26.9	43.3
Malaysia	2.9	-37.9	681.2	205.1	217.8

Source: Bangladesh Bank, Monthly Economic Trends, March 2010

8 ADB, Bangladesh Quarterly Economic Update, December 2009

(3) Foreign Direct Investment
Foreign Direct Investment (FDI) is an important source of finance, yet FDI in Bangladesh is not so large. The amount of the country's FDI declined in 2009 from that of the previous year. If compared with past trends, FDI in 2008 seems to be unusually high due to large investment in the telecommunications sector, making the record in 2009 look even smaller. The low FDI in 2009 could be also explained by the chronic shortage of energy supply in the country and the global economic slowdown.

Table 2-10: Trend of FDI

Unit: million USD

Calendar year	2005	2006	2007	2008	2009
FDI Flows	845.3	792.5	666.4	1,086.3	535
Out of which					
Telecommunication	278.8	346.5	201.9	641.4	NA
Textiles & Clothes	96.5	70.1	102.4	126.4	NA
Banking	117.8	117.7	80.0	141.8	NA

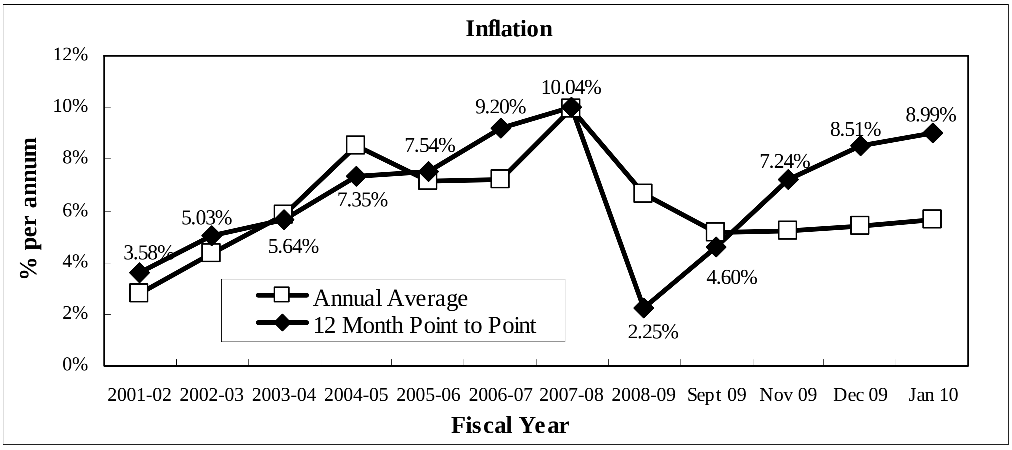
Source: "Foreign Direct Investment (FDI) in Bangladesh, Survey Report," July –December, 2008, BB and Monthly Economic Update

(4) Current account balance and balance of payments
With the lower deficit in the trade balance and the still increasing volume of remittances, the current account surplus rose to USD 2,536 in FY 2009 from USD 702 in FY 2008. These conditions posed appreciation pressures on the currency, Taka, and allowed BB to continuously purchase foreign exchanges leaving Taka liquidity unsterilized (excess liquidity is described in Chapter 4.3). The overall balance of payments recorded a significant surplus of USD 2,058 million in FY 2009, which was much higher than the surplus of USD 331 for FY 2008. Gross foreign exchange reserves increased by USD 1,322 million to USD 7,471 million at the end of FY 2009, which was sufficient to cover approximately 4.4 months of imports. Due to sluggish exports, the real GDP is expected to grow moderately at 5%, but the outlook is broadly unchanged[9].

2.3.2 Inflation

Inflationary pressure, originating from the burst in global commodity prices during FY 2008, continued into the first quarter of FY 2009 but eased thereafter with the melt down of the world economy. A good domestic harvest also contributed to bringing down food and grain prices. Inflation went up to 9.94% on the annual average basis in FY 2008 but declined to 6.66% in FY 2009. The 12 month point-to-point[10] was as high as 10.04% in June 2008 but came down to 2.25% in June 2009. It has been noted, however, that the twelve month point-to-point indexes of CPI increased in the first half of FY 2009-10 when Taka liquidity had been left unsterilized. Increases in food prices pushed up the general inflation as food inflation rate reached 10.56 while non-food inflation rate did 6.53 (point-to-point basis) in January 2010. Concerns over inflation led BB to increase the Cash Reserve Requirement (CRR) and the Statutory Liquidity Ratio (SLR) in May 2010 (details are described in Chapter 4.1 The Financial Sector in Bangladesh). The following figure illustrates inflation based on the CPI annual average and the 12 month point-to-point indexes;

9 IMF, Statement issued in Dhaka on April 12, 2010 after the conclusion of an IMF staff visit to Bangladesh.
10 12 month point-to-point is taken as synonymous with year-to-year percentage change at the time of comparison.



Source: Bangladesh Bank, Annual Report 2008-2009, Bangladesh Bank, Monthly Economic Trends, March 2010

Note 1: The rate indicates the percentage at end of each period. For example, 6.66% in FY 2008-2009 is the 12 month average in June 2009.

Note 2: Percentages in January 2010 are the 12 month average in January 2010 and the point-to-point rate in January 2010, respectively.

Figure 2-10: Trends of CPI

2.4 Development Policies

2.4.1 National Strategy for Accelerated Poverty Reduction II

The Government of Bangladesh listed the following five strategic blocks for pro-poor economic growth in the medium term development plan, titled the "National Strategy for Accelerated Poverty Reduction II" (NSAPR II (2009-11)) [11].

Strategic Block I.	Macroeconomic Environment for Pro-poor Economic Growth
Strategic Block II.	Critical Areas of Focus for Pro-poor Economic Growth
Strategic Block III.	Essential Infrastructure for Pro-poor Economic Growth
Strategic Block IV.	Social Protection for the Vulnerable
Strategic Block V.	Human Development

Above all, SME development is important in Strategic Block II: critical areas of focus for pro-poor economic growth. SMEs are expected to play a key role in achieving the national goals of accelerated pro-poor growth, sustained poverty reduction and a faster rate of economic development and social progress during the NSAPR II. Analysis shows that the constraints and challenges faced by the sector range from lack of access to finance to infrastructural bottlenecks (especially unreliable access to power), low levels of technological competence, difficulties in market access and regulatory barriers. In the light of these constraints and challenges, NSAPR II addresses the issues related to access to finance, focusing on a comprehensive and inclusive credit policy, to human resources development focusing on fostering the entrepreneurial spirit, access to markets policy coordination, cooperation for policy implementation and so on. The policy support for SMEs is considered to be a facilitating role, removing operational bottlenecks, neutralizing market failures and providing necessary promotional support.

[11] As a sequel to the first Interim Poverty Reduction Strategy Paper (I-PRSP), the second PRSP titled "Moving Ahead: National Strategy for Accelerated Poverty Reduction for 2008/2009-2010/2011" was prepared by the General Economics Division, Planning Commission, Government of the People's Republic of Bangladesh. It was approved by the NEC in October 2008.

In terms of access to finance, NSAPR II envisions that the policy needs to feature the following points:

(1) Increase in the flow of formal private sector credit into the SME sector
(2) Scaling down of collateral requirements for SME loans and a switch from immovable assets to movables assets for collaterals
(3) Lowering of high interest rates charged on SME loans by the commercial banks

2.4.2 Outline Perspective Plan for Bangladesh 2010-2021

The Awami League, the current government, set out Vision 2021 as a manifesto during the recent electoral campaign. After the Awami League came to power, the Government made this the long-term strategy for economic development in Bangladesh with numerical targets and strategic plans, naming it Outline Perspective Plan (OPP) of Bangladesh 2010-2021 (Making Vision 2021 A Reality)[12]. This OPP is the national strategy replacing NSAPR II (2009-11). In addition, in line with the OPP, the government of Bangladesh has been drafting a five year development plan for 2010-2015. It will be completed by December 2010.
In the OPP (2010-2021), the following items are listed as areas for action:

- Building a secular, tolerant, liberal, progressive, democratic state
- Promoting good governance and curbing corruption
- Promoting sustainable human development
- Instituting a prudent macroeconomic policy mix
- Promoting a favorable industrialization and trade policy regime
- Addressing globalization and regional cooperation challenges
- Ensuring an adequate supply of electricity and fuel
- Achieving food security
- Making available adequate infrastructure
- Pursuing environmental friendly development and
- Building a digital Bangladesh

Above all, in the chapter, *Instituting a prudent macroeconomic policy mix*, the strategies of macroeconomic development are given numeral targets as shown in Table 2-11 below.

Table 2-11: Key Macroeconomic performance targets

	Benchmark FY 09 (Note)	Target FY 15	Target FY21
Real GDP growth (%)	5.9	8.0	10.0
As percent of GDP			
Gross Investment (%)	24.2	32.1	37.5
Gross Domestic Savings (%)	24.0	27.0	30.0
Total government revenue (%)	10.4	15.5	17.1
Total government expenditure (%)	13.8	20.5	21.8
Export (%)	16.1	22.0	26.0
Import (%)	21.4	30.0	32.0
Trade balance (%)	-5.3	-6.0	-6.0
Remittances (%)	8.3	8.0	12.0
Current Account Balance (%)	1.0	2.0	6.0

[12] The draft was issued by the General Economics Division of the Planning Commission in March 2010.

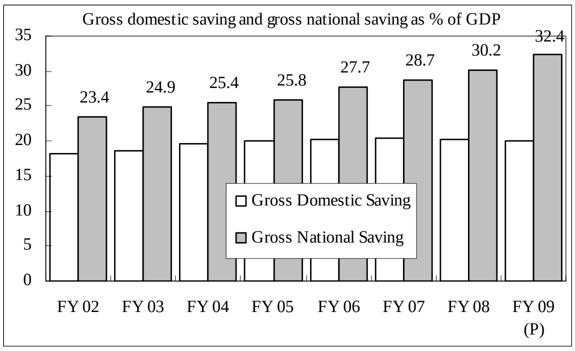
	Benchmark FY 09 (Note)	Target FY 15	Target FY21
Exports (billion USD)	15.6	36.3	91.1
Imports (billion USD)	20.3	49.6	131.3
Remittances (billion USD)	9.7	22.7	48.5
CPI inflation (%)	6.7	7.4	7.9
Unemployment rate (%)	30.0	16.0	10.0
Poverty (head count, %)	36.0	24.5	14.4

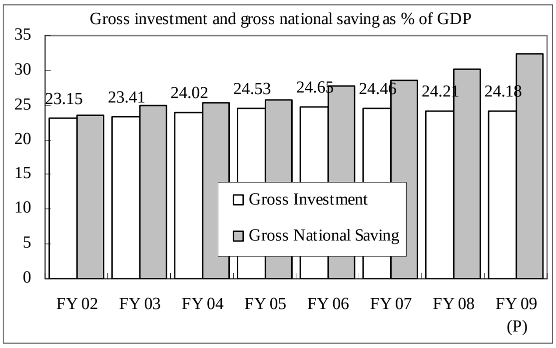
Source: General Economics Division Planning Commission, GOB, Draft Outline Perspective Plan of Bangladesh 2010-2021 (Making Vision 2021 A Reality), March 2010

Note 1: Averages from FY 04 to FY 09 have been taken for the proportions of Export, Import, Trade Balance, Remittances and Current Account Balance.

Note 2: Figures may not necessarily add up for unknown reasons.

The OPP expects Gross Investment to increase over the next 10 years from 24.2 % of GDP in FY 2009 to 37.5% in FY 2021, but does not expect Gross Domestic Savings to increase as fast. The following figures present past trends for Gross Domestic Savings, Gross National Saving and Gross Investment as percentages of GDP in the respective years. In fact, as seen from the figures, Bangladesh has experienced excess savings since Gross National Savings continued to exceed Gross Investment, thanks to the remittances.





Source: BBS (quoted from MOF, Bangladesh Economic Review 2009)

Note 1: P=Provisional

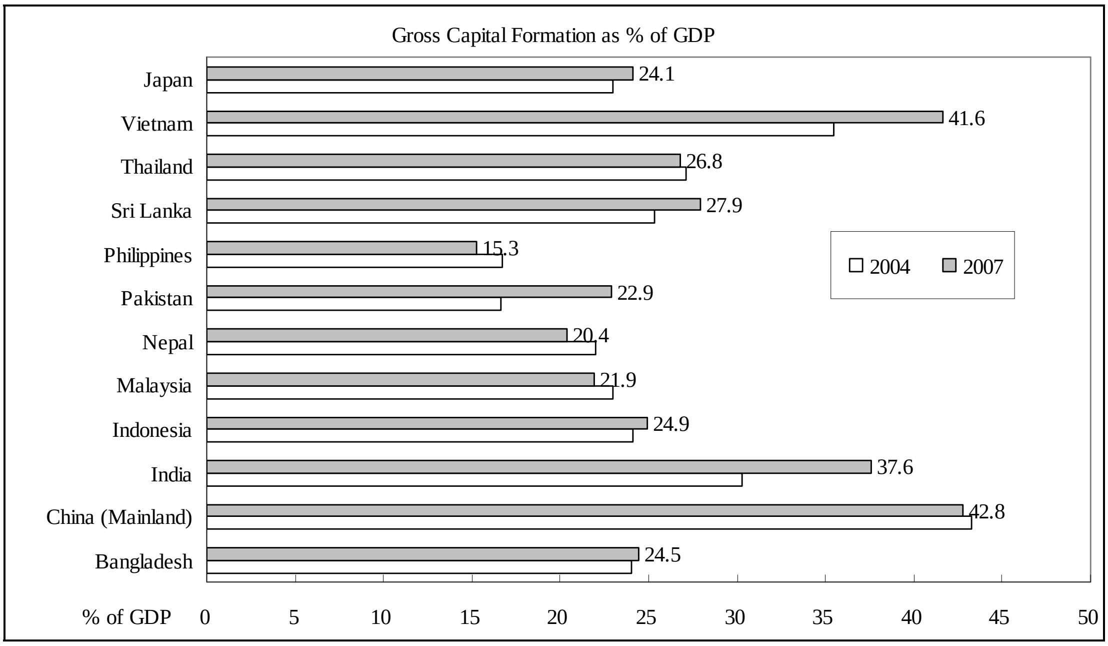
Note 2: BBS likely classifies remittances as Net Factor Income from abroad which has been increasing, so that IS Gap is narrowed.

Figure 2-11: GDS and GNS as % of GDP

Figure 2-12: GNI and GNS as % of GDP

While the trade balance continues to be negative, remittances are expected to increase up to 12.0% of GDP, leading to an increase in a positive balance of the current account.

In order to have good a understanding of the level of investment targeted by the OPP, Figure 2-13 below has been prepared to compare the level of gross investment against GDP in 2004 and 2007 among different countries. It can be seen that the level targeted in the OPP for Bangladesh is comparable to the level of India and Vietnam in 2007.



Source: The World Bank, World Development Indicators 2009, April 2009. For data for Bangladesh, BB, Annual Report 2008-2009
Note: For data for Bangladesh, data for the fiscal year is used, where 2004 means FY 2004 (from July 2003 to June 2004).

Figure 2-13: Comparison of Gross Capital Formation as a Percentage of GDP among different countries

In order to achieve these macroeconomic performance targets for 2021, GOB has recognized that the industrialization process will need to be geared up significantly, and it has set strategic targets for industrialization as in Table 2-12. This shows that GOB will focus on promoting especially manufacturing sector in industry.

Table 2-12: Sectoral change (sectoral share of GDP, %)

	Benchmark FY 09	Target FY 15	Target FY21
Agriculture	21.68	16.0	12.0
Industry	28.98	30.0	36.0
Manufacturing	17.14	26.0	30.0
Service	49.35	54.0	52.0

Source: General Economics Division Planning Commission, GOB, Draft Outline Perspective Plan for Bangladesh 2010-2021 (Making Vision 2021 A Reality), March 2010

The OPP pursues SME-based industrialization. SMEs are seen not as conventional enterprises but more broad-based, higher skill-intensive and competitive enterprises. In order to achieve these targets, the OPP takes it as given that not only the growing domestic market will be catered to, but also that SMEs will be enabled to link-up with foreign markets through a package of support including credit, common services, skills-up gradation and institutional support.

In traditional labor-intensive sectors, such as RMG, leather and frozen-food, initiatives will be taken for further strengthening through promoting, product diversification and stimulating an up-market move. Moreover, in new sectors identified as important sectors in the Industrial Policy 2010, such as ICT-based sectors, food, beverages, light engineering, cement, high-end

RMG, pharmaceuticals, ship-building and others, policy support and promotional initiatives will be taken. Export incentives such as bonded warehouse facilities, duty drawbacks and institutional/infrastructural support in the form of the establishment of industrial parks, dedicated private sector EPZs and SEZs will be put in place to stimulate growth. Facilities shall also be developed for entre pot export in order to promote the above mentioned new sectors.

3. Small and Medium-sized Enterprises in Bangladesh

3.1 Definition of SME

A number of definitions of SMEs have existed in Bangladesh. Classification of SMEs was made in terms of sectors as well as the value of assets, the number of employees and/or the amount of sales. Depending on the organization or study, the profile of SMEs used to vary. Table 3-1 on the following page compares the definitions given by four organizations/policy papers/studies.

On June 12, 2008, the SME wing of MOI issued a circular which provided a new definition of SMEs, which was unanimously agreed among BB[1], the Ministry of Industries (MOI), Bangladesh Bureau of Statistics (BBS) and Board of Investment (BOI). The following summarizes the uniform definitions applied to SMEs by these four organizations.

SMEs:
SMEs will mean an establishment which is not a public limited company and fulfills the following criteria:

Small enterprise

Sector	Total Fixed Assets excluding land and building (Million Tk.)	Employment of Labour up to
Services	0.05 – 5.0	25
Trading	0.05 – 5.0	25
Manufacturing	0.05 – 15.0	50

Medium enterprise

Sector	Total Fixed Assets excluding land and building (Million Tk.)	Employment of Labour up to
Services	5.0-100.0	50
Trading	5.0-100.0	50
Manufacturing	15.0-200.0	150

[1] BB Circular No.8, ACSPD dated May 26, 2010

Table 3-1: Comparison of definitions of SMEs among different organizations/policy papers/studies

Organization /Policy/Study	Small enterprises						Medium enterprises					
Industrial policy 2005	Manufacturing sector		Non-manufacturing sector				Manufacturing sector		Non-manufacturing sector			
	Fixed assets	Employees	Fixed assets	Employees			Fixed assets	Employees	Fixed assets	Employees		
	Below Tk.15 Mil.			Less than 25			Tk.15 Mil. to 100 Mil			25 to 100		
Bangladesh Bank	Manufacturing		Services		Trading		Manufacturing		Services		Trading	
	Total fixed assets excluding land and building	Employees	Total fixed assets excluding land and building	Employees	Total fixed assets excluding land and building	Employees	Total fixed assets excluding land and building	Employees	Total fixed assets excluding land and building	Employees	Total fixed assets excluding land and building	Employees
	Tk 50,000 to 15 Mil.	Less than 50	Tk 50,000 to 5 Mil.	Less than 25	Tk 50,000 to 5 Mil.	Less than 25	Tk 15 Mil.to 200 Mil.	Less than 150	Tk 5 to 100 Mil.	Less than 50	Tk 5 to 100 Mil.	Less than 50
Bangladesh Bureau of Statistics	Employees						Employees					
	Fewer than 10						10 to 49					
World Bank (Investment climate survey 2008)		Employees						Employees				
		10 to 49						50 to 99				

Source: Policy Analysis Unit of Bangladesh Bank, "A Note on the Contribution of Small and Medium Enterprises to GDP in Bangladesh," Policy Paper 0806, June 2008.
The World Bank, Harnessing Competitiveness for Stronger Inclusive Growth - Bangladesh Second Investment Climate Assessment, Bangladesh Development Series Paper No.25, Oct 2008.

Note: Exchange rate: USD = 70 Tk

MOI is expected to issue the Industrial Policy 2010 and Strategies for SMEs with new definitions of SMEs. Based on the draft Industrial Policy 2010 that the JICA Survey Team obtained in May 2010, the following table compares the definitions given in the draft Industrial Policy 2010[2] with the existing definitions of SMEs used by BB.

Manufacturing Sector

Policy	Current definition of SME by BB		Industrial Policy 2010 (Draft)	
Type	Total fixed assets excluding land and buildings	Employment of workers	Value/replacement cost of durable resources (fixed investment) excluding land and buildings	Employment of workers
Cottage			Less than Tk 0.5 mil.	Up to 10
Micro			Tk 0.5 mil to Tk 5.0 mil., or	Up to 24
Small	Tk 0.05 mil to 15.0 mil.	Up to 50	Above Tk 5.0 mil. to Tk 100 mil., Or	Between 25 and 99
Medium	Tk 15 mil. to Tk 200 mil.	Up to 150	Above Tk. 100 mil. to Tk 300 mil., or	Between 100 and 250
Large	.		Above Tk. 300 mil., or	Greater than 250

Non-manufacturing sector

Policy	Current definition of BB for Services and Trading		Industrial Policy 2010 (Draft)	
Type	Total fixed assets excluding land and buildings	Employment of workers	Value/replacement cost of durable resources (fixed investment) excluding land and buildings	Employment of workers
Small	Tk 0.05 mil to Tk 5.0 mil	25	Tk 0.5 mil to Tk 10 mil., or	10 to 25
Medium	Tk 5.0 mil to Tk 100.0 mil	50	Above Tk 10.0 mil to Tk 150 mil, or	50 to 100
Large			Above Tk 150 mil, or	Above 100

Note 1: In the current definitions used by BB, SMEs will mean an establishment that is not a public limited company.

Note 2: In Industrial Policy 2010 (Draft), a SME could be classified into two different categories when both fixed investment criteria and employment criteria are applied. In this case, the SME will be classified into a larger enterprise.

Note 3: The category for employment of workers from 26 to 49 in the non-manufacturing sector under the draft Industrial Policy 2010 is missing for unknown reasons.

A comparison between existing and draft definitions of SMEs reveals the following points, which are especially relevant to the current JICA survey:

(1) The amount of fixed investment and the number of employees have increased in both the manufacturing and the non-manufacturing sectors. For example, the upper limit of fixed investment excluding land and buildings has increased from Tk 15 million to Tk 100 million for a “small manufacturer”.

(2) The new definition gives a definition to micro enterprises by setting a lower limit at Tk 0.5 million and a upper limit at Tk 5.0 million of fixed investment excluding land and buildings, although there is no definition given to micro enterprises in the non-manufacturing sector.

[2] The definitions of SMEs in the draft Industrial Policy may be changed in the final form of the Industrial Policy.

(3) Under the draft definition of SMEs, most of enterprises are likely to be classified into micro-enterprises.[3]

Unlike the Industrial Policy 2005, definitions of "women entrepreneurs" are also given in the draft Industrial Policy 2010 as follows: if any women becomes proprietor of a private company or proprietary enterprise, or partner in a partnership organization or any private company registered under the joint stock company and holding at least 51% of the shares will be considered as those of a women entrepreneur.

As of June 2010, the new Industrial Policy has not been finalized yet and the definition of SMEs proposed in the draft is still subject to change. The JICA Survey Team is of the opinion that the proposed project uses the existing uniform definition that the four concerned organizations unanimously agreed with in 2008 for the time being. Once the new definition has been finalized and agreed by concerned parties, a steering committee will be held to decide the definition appropriate for the project.

3.2 Current situation for the SME Sector

3.2.1 The latest situation for SMEs

(1) Overview of the SME sector

Statistics showing the latest situation for SMEs in accordance with the definitions is not available. Therefore, this section presents the situation for SMEs based on the definition previously used by different organizations or studies. The overview covers the number of SMEs and employment by major economic sector, outputs, gross value added and contribution to the GDP.

The survey conducted by ICG[4] in 2003 analyzed the number of micro-enterprises and SMEs (MSMEs)[5] and their contributions to the GDP. The total number of MSMEs was estimated at 5.9 million with the number of people employed being about 31 million. The total contribution of MSMEs was estimated at Tk 741.3 billion. If this estimate is compared to the total GDP of Tk 2,898.7 billion at current producer's price in FY 2002-03,[6] MSMEs accounted for about 25% of the GDP[7]. However, it is not clear how much of Tk 741.3 was taken into account in the official GDP statistics. The sectoral distribution of MSMEs' contribution to the GDP can be compared with the GDP in FY 2002-03 as follows.

[3] According to a sample survey conducted by ADB in 2007-2008, surveyed firms are classified in accordance with the size of fixed investment. About 73% fall in micro enterprises with the fixed investment up to Tk 2.655 million, 18 % in small ones with fixed investment from Tk 2.656 million to Tk 15.0 million and 7% in medium ones with fixed investment from Tk 15.0 million to Tk 100.0 million. (ADB, Towards an Evidence Base for Efficient, Proactive and Inclusive SME Development: National-wide sample survey 2007/2008)

[4] Lisa Daniels, International Consulting Group, National Private-sector Survey of Enterprises in Bangladesh, 2003, October 2003.

[5] MSMEs are defined as enterprise with up to 100 workers under the study. Enterprises are defined in broader terms as "any income-generating activity that markets at least 75 % of its product" and only non-agricultural activities are included. However, rickshaws are excluded from the study.

[6] BBS, Statistical Yearbook of Bangladesh 2007.

[7] It was estimated that enterprises having 10 workers or less cotributed more than 85% of the contribution made by MSMEs to GDP.

Table 3-2: Estimated number of MSME and estimated contribution of MSME to the total GDP in FY 2002-03

Sector	Estimated number of MSME (1000)	Contribution by MSME (100 workers or less) (Tk million) [X]	Total GDP (Tk million) [Y]	Contribution by MSME [X/Y (%)]
Agriculture	1,313.8	177.7	488.0	36.4%
Fishing	228.6	32.9	142.6	23.1%
Manufacturing	857.3	**282.3**	**458.1**	**61.6%**
Construction	77.1	7.2	230.2	3.1%
Wholesale & retail trade and repairs	2381.2	**171.3**	**391.0**	**43.8%**
Hotels & restaurants [Note]	278.0	28.6	19.4	147.1%
Transport, storage, & communications	166.6	9.0	311.1	2.9%
Real estate, renting, & business activities	179.3	13.8	256.8	5.4%
Education	2.5	0.2	70.6	0.2%
Health and social work	53.4	2.7	66.0	4.2%
Other service activities	154.7	15.6	0.0	
Others	241.7	0.0	464.8	
Total	5,934.2	741.3	2,898.7	25.6%

Source: Lisa Daniel (2003), BBS (2007)

Note: The contribution of MSMEs in hotel restaurant sector exceeds the total amount of the same sectoral GDP. It is not known how much of the MSMEs' contributions were taken into account under the official GDP statistics. In addition, classification of sectors in the BBS statistics is not exactly same as the one used in the study. The above table presents a rough estimate of the contributions.

The above table shows MSMEs' contributions are about 60% in the manufacturing sector and about 40% in the wholesale & retail trade.

The following table shows the number of establishments[8], number of persons engaged, gross output and gross value added based on the results of BBS's economic survey[9] in 2001-2002 and 2002-2003. An economic survey conducted by BBS covered the following sectors: (1) large and medium scale manufacturing with handloom establishments; (2) small manufacturing: (3) wholesale & retail trade; (4) hotel & restaurant; (5) service[10]; and (6) household based economic activities (both manufacturing and non-manufacturing). The total number of establishments was estimated at about 3.1 million with 9.27 million persons engaged in the activities. Out of the total number of establishments, about 3.4 million (84%) were the establishment with the number

[8] "Permanent establishment" is defined as a unit which is in use for the purpose of collection, production, buying & selling and distribution of goods, or any kind of social work, business or services, whether they are owned & controlled by the government, person, group of persons or society. For example, any factory, shop, hotel, restaurant, mosque or temple, etc. with permanent structure(s) and fixed physical location is considered as a permanent establishment (BBS).

[9] BBS, Report on census of manufacturing industries, 2001-02, April 2007 and BBS, Report on annual establishments and institutions survey, 2002-03, July 2007. Both surveys were conducted through a sample survey. The former is related to (1) large and medium scale manufacturing industries and the latter is concerned with sectors from (2) to (6). The survey for the latter report was conducted from July to December 2003 with a reference period of Fiscal Year 2003.

[10] Establishments in the service sector include education, health and social work, renting of machinery equipment, research and development, and computer & related activities.

of persons ranging from 1 to 9 and those running household business on a small scale[11]. For the purpose of the analysis, “small” and “medium” are defined as establishments with persons between 10 and 49 and between 50 and 99, respectively in order to examine the contribution of SMEs. In the manufacturing sector, for instance, it is estimated that SMEs contributed about 32% to the gross value added in the manufacturing sector in 2002-2003 and about 12% in terms of employment. In terms of the number of establishments, SMEs accounts for as small as 4.4%. In the segment that employs less than 10 persons, a large number of household manufacturing and cottage industries are observed. These establishments are considered to be micro-enterprises that are likely to be beneficiaries of Microfinance Institutions (MFIs). On the other hand, there are a relatively small number of large establishments. It is estimated that these large establishments employ a big number of workers and accounts for quite a big share of the gross value added.[12]

Table 3-3: Number of establishments, persons engaged, gross output and gross value added in FY 2003

<table>
<tr><th>Size and sector</th><th>No. of establishments</th><th colspan="2">No of persons engaged</th><th>Gross output (Tk billion) Note2</th><th colspan="2">Gross value added (Tk billion)</th></tr>
<tr><td>(1) Manufacturing</td><td></td><td colspan="2"></td><td></td><td colspan="2"></td></tr>
<tr><td>Household manufacturing</td><td>284,141</td><td colspan="2">1,082,957</td><td>92.6</td><td colspan="2">31.6</td></tr>
<tr><td>1-9</td><td>211,400</td><td colspan="2">631,799</td><td>101.5</td><td colspan="2">34.2</td></tr>
<tr><td>10-49 Note1) (small)</td><td>19,942</td><td colspan="2">345,979</td><td>74.4</td><td colspan="2">20.9</td></tr>
<tr><td>50-99 Note1) (medium)</td><td>2,782</td><td rowspan="2">2,473,071</td><td>208,650</td><td rowspan="2">868.4</td><td rowspan="2">283.2</td><td>97.0</td></tr>
<tr><td>100- Note1)</td><td>5,341</td><td>2,264,421</td><td>186.2</td></tr>
<tr><td>Sub-total</td><td>518,265</td><td colspan="2">4,533,806</td><td>1,136.8</td><td colspan="2">369.8</td></tr>
<tr><td>SME/Total</td><td>4.4%</td><td colspan="2">12.2%</td><td></td><td colspan="2">31.9%</td></tr>
<tr><td>(2) Wholesale and retail trade</td><td></td><td colspan="2"></td><td></td><td colspan="2"></td></tr>
<tr><td>1-9</td><td>1,572,451</td><td colspan="2">2,076,399</td><td>725.4</td><td colspan="2">124.0</td></tr>
<tr><td>10-19 (small)</td><td>1,428</td><td colspan="2">20,367</td><td>3.4</td><td colspan="2">0.9</td></tr>
<tr><td>20 or more</td><td>454</td><td colspan="2">29,411</td><td>60.1</td><td colspan="2">11.4</td></tr>
<tr><td>Sub-total</td><td>1,574,333</td><td colspan="2">2,126,177</td><td>788.9</td><td colspan="2">136.3</td></tr>
<tr><td>Small/Sub-total</td><td>0.1%</td><td colspan="2">1.0%</td><td>0.4%</td><td colspan="2">0.7%</td></tr>
<tr><td>(3) Hotel & restaurant</td><td></td><td colspan="2"></td><td></td><td colspan="2"></td></tr>
<tr><td>1-9</td><td>212,383</td><td colspan="2">435,116</td><td>60.6</td><td colspan="2">19.2</td></tr>
<tr><td>10-19 (small)</td><td>2,185</td><td colspan="2">27,092</td><td>3.4</td><td colspan="2">1.4</td></tr>
<tr><td>20 or more</td><td>535</td><td colspan="2">15,495</td><td>2.4</td><td colspan="2">1.1</td></tr>
<tr><td>Sub-total</td><td>215,103</td><td colspan="2">477,703</td><td>66.5</td><td colspan="2">21.7</td></tr>
<tr><td>Small/Sub-total</td><td>1.0%</td><td colspan="2">5.7%</td><td>5.2%</td><td colspan="2">6.4%</td></tr>
<tr><td>(4) Service industries</td><td></td><td colspan="2"></td><td></td><td colspan="2"></td></tr>
<tr><td>1-9</td><td>620,645</td><td colspan="2">1,280,671</td><td>92.6</td><td colspan="2">74.2</td></tr>
<tr><td>10-19 (small)</td><td>18,943</td><td colspan="2">250,201</td><td>14.1</td><td colspan="2">12.6</td></tr>
<tr><td>20 or more</td><td>6,825</td><td colspan="2">436,010</td><td>124.2</td><td colspan="2">116.5</td></tr>
<tr><td>Sub-total</td><td>646,413</td><td colspan="2">1,966,882</td><td>230.9</td><td colspan="2">203.2</td></tr>
<tr><td>Small/Sub-total</td><td>2.9%</td><td colspan="2">12.7%</td><td>6.1%</td><td colspan="2">6.2%</td></tr>
<tr><td>(5) Household other than manufacturing</td><td>137,989</td><td colspan="2">165,477</td><td>13.1</td><td colspan="2">5.4</td></tr>
</table>

[11] Household establishment is defined as an establishment that has been placed only in the small group irrespective of the number of persons engaged.

[12] The big share of the gross value added does not necessarily mean that large firms are more productive than smaller firms as analyzed in Chapter 3.2.3.

Size and sector	No. of establishments	No of persons engaged	Gross output (Tk billion) Note2	Gross value added (Tk billion)
Total (1) to (5)				
Household	422,130	1,248,434	105.6	36.9
1-9	2,616,879	4,423,985	980.1	251.6
10 or more	53,094	3,597,626	1,150.5	447.9
Total	3,092,103	9,270,045	2,236.3	736.4

Source: BBS, Report on annual establishments and institutions survey, 2002-03, July 2007. BBS, Report on census of manufacturing industries, 2001-02, April 2007.

Note 1: The reference period of the data for establishments with persons above 10 in the manufacturing sector is FY 2001-02 in terms of the number of establishments and persons engaged, which is different from the rest of the data (FY 2002-2003) in the table above. The data for the gross output and gross value added for the manufacturing sector have been adjusted with the GDP deflator. The number of persons engaged was estimated by the average number multiplied with the number of establishments (75 workers x 2,782 establishments) and the gross value added for establishments with persons above 50 was estimated in proportion to the number of establishments in the respective brackets.

Note 2: Some of the figures presented in the table above are quite different from GDP measured in current producer's price. In 2002-2003, the manufacturing sector recorded Tk 458.1 billion consisting of Tk 323.8 billion for large and medium scale and Tk 134.3 billion for small scale, the wholesale and retail trade sector Tk 391.0 billion, hotel and restaurant Tk 19.4 billion and Transport, storage and communication sector Tk 311.1 billion.

Other than the manufacturing sector, it is not possible to disaggregate establishments into SMEs and large enterprises.

In terms of the growth rate of labor force and employment, the average yearly growth rate of the labor force was 2.90% in a period between 1986 and 2006 while the annual employment growth rate in the same period was 2.61%. On the other hand, in the small enterprises, employment grew at the rate of 4.8% between 1978 and 1991 and 5.5% between 1991 and 2001. In the case of the medium enterprises, employment growth was estimated at 9.6% from 1988 to 2003[13]. SMEs exhibited a high rate of employment generation.

3.2.2 Analysis of SMEs in the Manufacturing Sector

This section looks more closely at the manufacturing sector. The tables below (Table 3-4, Table 3-5) show establishments with 10 or more persons engaged in the manufacturing sector classified by size of persons and size of fixed assets. Most of the enterprises, particularly SMEs, belong to the private sector. Those are classified into micro establishments (11 to 24 persons) by the definition (workforce criterion) of the draft Industrial Policy 2010, and account for more than 25%, while small establishments (25 to 99 persons) reach around 55% of the total number. In Table 3-4 and Table 3-5, several interesting observations can be made. Firstly, a majority of establishments would be classified into micro or small if the definition of the draft Industrial Policy 2010 is applied; secondly, the average number of persons per enterprise increases particularly when fixed assets exceed Tk 1.0 million; thirdly, the average of Gross Value Added (GVA) per person is about Tk 100,000, ranging from Tk 25,000 to Tk 125,000 as the fixed assets size increase. The GVA per person shows an increasing trend in accordance with the size of the fixed assets.

[13] BB, A Note on the Contribution of Small and Medium Enterprises to GDP in Bangladesh, Policy Paper 0806, June 2008. This article used the BBS definition for the analysis where small enterprises are defined as establishments that have fewer than 10 workers and medium enterprises are establishments that have more than 9 workers and less than 50 workers.

Table 3-4: Establishments by number of employees

Employment size	No of establishment		Ownership of establishments by employment size classification		
			Government	Private	J/V
10-19	7,094	25.3%	0	7,094	0
20-49	12,849	45.8%	5	12,837	7
50-99	2,782	9.9%	5	2,765	12
100-199	1,838	6.5%	21	1,798	20
200 and above	3,503	12.5%	107	3,340	56
Total	28,065	100.0%	138	27,833	94

Source: Census of manufacturing industries, 2001-02 prepared by BBS in 2007

Table 3-5: Number of persons per establishment and productivity by fixed asset size

Tk 1000

Fixed assets size	No. of establishments	Ratio	No of persons per establishment	Gross value added per person (Tk 1000)
Up to Tk 50	414	1.5%	26.3	281.0
Tk 51 to 100	154	0.5%	11.2	25.5
Tk 101 to 200	1,633	5.8%	10.5	30.9
Tk 201 to 500	4,398	15.7%	16.0	26.6
Tk 501 to 1,000	2,615	9.3%	21.6	38.0
Tk 1,001 to 2,000	1,500	5.3%	44.8	45.5
Tk 2,001 to 5,000	3,025	10.8%	70.5	42.6
Tk 5,001 to 10,000	2,982	10.6%	117.8	50.8
Over 10,000	11,343	40.4%	179.0	124.7
Total	28,064	100.0%	100.5	103.2
Total without data of establishment of up to Tk 50.	27,650		101.6	102.5

Source: BBS, Report on census of manufacturing industries, 2001-02, April 2007

Note 1: No adjustment has been made to the price level of the fixed assets.

Note 2: The data for establishments with fixed assets up to Tk 50,000 seems to contain some extreme outliers or irregularities.

Under the ADB-assisted SMESDP, a sample survey was conducted from 2008 to 2009, focusing on 20 industrial sectors. The sampling framework for the survey was the BBS Business Registry 2007[14] and the total effective responses were 3,943 out of 4,000 samples taken. In accordance with the definition of the Industrial Policy 2010 (Draft), the number of enterprises was classified as in the table below. SMEs accounts for about 30% of the total number while about 60% falls in the segment of cottage and micro enterprises.

The table below (Table 3-6) shows the GVA per person engaged in each segment. Unlike the data in FY 2001-02, the average and median GVA of medium enterprises was lower than those of other segments. The average GVA of large firms is lower than those of micro and small enterprises.

[14] Due to lack of data on micro enterprises, the number of micro enterprises as of 2007 was estimated based on the compound annual growth rate for the period between 2002 and 2007 with respect to the “small” category. As a result, the total number in the sampling framework reached 685,723. For the determination of the sample size of 4,000, the survey also utilized the Investment Climate Survey 2002 of the World Bank and the Census of Manufacturing Industries (CMI) 2001-2002.

In Bangladesh, it has been found that larger firms show stronger employment growth than smaller firms: however, firm size is negatively associated with firm labor productivity and firm Total Factor Productivity (TFP) under the condition that capital intensity is controlled for in the analysis[15] [16]. The empirical analysis attributes the reason to the protection of larger firms from competition in the forms of subsidies, other privileges and minimal entry into and exit from the industries. It also points out that financial markets failed to inject resources into more productive smaller firms, allowing large firms to keep hoarding them.

Table 3-6: Sample survey results for the manufacturing sector under ADB-assisted SMESDP

Unit: Tk 1000

	Up to 10 persons	11 to 24	25 to 99	100 to 250	251-	Average or median of total
	Cottage	Micro	Small	Medium	Large	
Total number of enterprises	992	1,426	906	367	252	
% of total sample size (3,943 samples)	25%	36%	23%	9%	6%	
Average GVA per person	237	417	398	298	375	354
Median GVA per person	131	137	159	103	174	138
Average total capital employed (TCE)[Note] per firm	31,600	6,206	22,994	1,136,029	158,975	131,376
Median TCE per firm	420	1,321	5,407	14,560	39,175	1,965

Source: Towards an Evidence Base for Efficient, Proactive and Inclusive SME Development: National-wide sample survey 2007/2008 (The dataset has been provided through the courtesy of Dr. Naeem Chowdhury, Maxwell Stamp Limited)

Note: Total capital employed (TCE) includes both fixed assets (machinery and plant on a replacement cost basis, which exclude values of land and buildings) and working capital such as net receivables.

The ADB survey used the concept of "total capital employed (TCE)," which includes both fixed assets (machinery and plant on a replacement cost basis, which excludes values of land and buildings) and working capital, such as net receivables. Thus, TCE can be interpreted as capital required for production. The median value of TCE across the sector was about Tk 2.0 million. The median value of TCE for small enterprises was Tk 5.4 million and that for medium enterprises was Tk 14.5 million. These amounts of TCE could be compared with available loan sizes in the table below.

The table also shows percentages of firms that have at least one bank or leasing company loan on its book by firm size[17] and an average institutional loan size. As seen from the table, most of the industrial sectors, micro and small firms have smaller percentages of the firms with loans than medium-and large-enterprises. In terms of the average of the institutional loan size, a few sectors show that the average amount was larger than Tk 3.0 million. The current level of loan utilization in the light of capital required for production indicates possible difficulties in accessing finance.

[15] The World Bank, Bangladesh Second Investment Climate Survey, 2008. The study found that the value added per worker and TFP of firms with more than 50 workers was on average 30% and 19%, respectively, lower than smaller firms.

[16] The aforementioned BB's Policy Paper 0806 in June 2008 made similar remarks in terms of the labor productivity (value added per worker). According to the paper, although value added as percent of gross output is lower for SMEs than for large firms, value added per worker and gross profit per worker are higher for SMEs.

[17] Due to small sample sizes in some of the sectors, the analysis was conducted by grouping micro and small into one category and medium and large into another.

Table 3-7: Sample survey results for the manufacturing sector under ADB-assisted SMESDP

Sector	Number of persons engaged (workforce definition of the draft Industrial Policy 2010)					% of firms that have at least one bank or leasing company loans on its book		Average institutional loan size (Tk 1,000)
	Up to 10 persons	11 to 24	25 to 99	100 to 250	251-			
	Cottage	Micro	Small	Medium	Large			
	No of enterprises					Micro/ Small	Medium/ Large	
Agro-processing	158	403	214	24	13	30.1%	41.1%	1,321
Leather	66	66	54	10	17	18.6%	42.3%	18,253
Non metallic minerals	35	18	66	223	30	32.9%	49.3%	2,733
Pharmaceuticals	4	17	21	5	13	8.8%	38.5%	5,887
Tobacco	2	5	2	2	10	0.0%	7.1%	24
Wood cork and Wood products	50	28	2	-	-	30.0%	-	649
Designer goods	52	120	149	11	11	8.6%	15.4%	170
Electrical	55	82	82	13	4	28.3%	51.6%	1,502
Furniture making	150	108	42	3	1	13.4%	50.0%	143
Light engineering	110	107	53	11	4	14.9%	25.7%	504
Medical, optical equipment	6	2	-	1	-	12.5%	0.0%	44
Motor vehicle products	2	4	4	1	1	25.0%	50.0%	355
Other transport	6	14	9	3	1	8.3%	22.2%	1,282
Plastic	48	92	70	17	9	35.0%	67.0%	8,747
Radio communication, television	1	5	-	-	-	50.0%	-	750
Knitwear	46	134	58	33	129	40.5%	17.3%	6,188
Printing and Publishing	71	122	40	1	4	19.9%	23.5%	313
Basic metallic	23	21	10	5	4	20.0%	23.1%	2,633
Paper and paper based goods	10	21	14	1	-	11.4%	100.0%	1,283
Parts and Components	97	57	16	3	1	11.5%	3.5%	529
Total number of enterprises	992	1,426	906	367	252			
% of total sample size (3,943 samples)	25%	36%	23%	9%	6%			

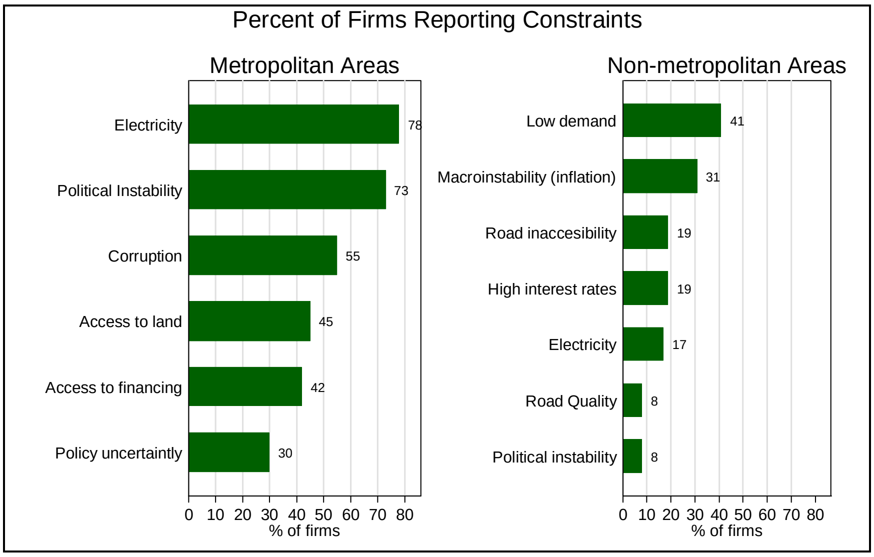
Source: Towards an Evidence Base for Efficient, Proactive and Inclusive SME Development: National-wide sample survey 2007/2008 (The dataset has been provided through the courtesy of Dr. Naeem Chowdhury, Maxwell Stamp Limited)

Note 1: There are reasons to believe that the above set of numbers for 2007 is an understatement.

3.2.3 Constraints on SMEs

This section describes types of constraints that enterprises in Bangladesh have faced, basically referring to the survey results of the Investment Climate (IC) Survey conducted in 2007. The analysis is supplemented with the results of the JICA Survey from April to May 2010 (Annex 1: Results of the SME interview survey). The analysis shows that similar types of constraints have brought about a varying degree of impact to SMEs.

Based on the survey conducted in early- to mid-2007, the second Investment Climate Assessment (ICA) reported the top five investment constraints for firms located in the metropolitan as well as non-metropolitan areas[18]. For firms located in the metropolitan areas, the highest concern is placed on the “electricity”, followed by “political instability”, “corruption”, “access to land”, “access to financing” and “policy uncertainty”. On the other hand, the firms located in non-metropolitan areas put the “low demand” on the top of the list, followed by “macro instability (inflation)”, “road inaccessibility”, “high interest rates”, “electricity”, “road quality”, and “political instabilities”.



Source: Investment Climate Survey, 2007 quoted by the Second Investment Climate Assessment (2008)

Figure 3-1: Major or Severe Investment Climate Constraints

(1) Electricity

Electricity continues to pose a major constrain to enterprises during the JICA survey period in 2010. Enterprises recorded large losses due to frequent failure of power supply. The newspaper article in April 2010 reported that because of the nagging power shortage, coupled with the delayed impact of the global recession, the overall exports growth was poised to drop to a single digit in FY 2010 for the first time in seven years.[19] In responding to the interviews, the president of Bangladesh Garments Exporters and Manufacturers Association commented that although local garments manufacturers witnessed a substantial rise in demand from foreign buyers since early 2010 with the recovery of financial turmoil, random power outages and insufficient gas supply forced many exporters to refuse orders. In the article mentioned above, a chairman of one of the State-owned Commercial Banks (SCBs) explained that “…, prior to sanctioning new loans, we’re placing a condition that the factories concerned must arrange for

[18] The World Bank, Harnessing Competitiveness for Stronger Inclusive Growth - Bangladesh Second Investment Climate Assessment, Bangladesh Development Series Paper No.25, Oct 2008. In the survey, the metropolitan sample was taken from the urban section, which comprises the six cities (Dhaka, Chittagong, Rajshahi, Khulna, Barisal, Sylhet. The sectors surveyed are food, garments, leather, textiles, chemicals/pharmaceuticals, light engineering, other manufacturing, other services, wholesale/retail, construction and transport. The total number of samples was 1,504 in the sample frame of 25,353. Out of the samples, the small (10-49 employees), medium (50-99) and large (100 or more enterprises are 759, 156 and 589, respectively. The non-metropolitan survey consisted of 2,520 non-farm enterprises located in 25 peri-urban areas around each of the six cities, 25 small towns and 121 rural areas. The non-metropolitan sample includes firms of all sizes, micro-enterprises with less than ten workers, SMEs, and rural households without enterprises.

[19] New Age April 2, 2010. The same article reported that a government committee was forced to scale down the export growth target to 8 % from the initial projection of 13% (USD 17.6 billion).

alternative power generation." The constraints relating to power supply have more severely affected smaller firms that were not able to afford power generators. The ICA reports that smaller firms lost 13.1% of sales values as compared to 8.4 % for large firms in Dhaka while smaller firms lost 12.4% as opposed to 7.7% in Chittagong. In the interview with 33 SMEs during the JICA survey period in 2010, 13 out of 35 responded that the frequent power failure was one of the most serious business issues that they faced.

(2) Political instability and corruption

Firms in metropolitan areas raised political instability and corruption (and governance) in the second and third issues. The Investment Climate survey was conducted during the first half of 2007 soon after the caretaker government took office and a state of emergency was declared. The caretaker government has arrested more than 500,000 people and jailed hundreds of prominent politicians and businessmen since January 2007 as part of an unprecedented anti-corruption drive.[20] Consequently, it is understandable to see that enterprises ranked these issues higher on the list.

(3) Access to land

Access to land, particularly to serviced land, is another important issue to enterprises in metropolitan areas. Smaller firms seem to have more difficulties in accessing to land as shown in the table below.

Table 3-8: Difficulties in accessing to land (Metropolitan sample)

% of firms which agree

Land issues	Small	Medium	Large	Sample mean
No. of workers	10-49	50-99	100 & above	
% land owned by the firm	52.6%	85.1%	61.6%	56.7%
Cost of land is among the top 3 obstacles to access to land	94.7%	89.8%	87.4%	92.5%
Procurement is among the top 3 obstacles to access to land	89.0%	87.8%	75.8%	85.2%
Infrastructure is among the top 3 obstacles to access to land	66.6%	64.9%	68.9%	70.4%

Source: The World Bank, Harnessing Competitiveness for Stronger Inclusive Growth - Bangladesh Second Investment Climate Assessment, Bangladesh Development Series Paper No.25, Oct 2008. (Annex A9.1).

Major problems are titling and registration of land. Property registration procedures take a long time (425 days in Dhaka) due to various reasons such as divided jurisdiction of land administration between different offices, manual and complex procedures. High registration fees and stamp duties are also another point to mention.

(4) Low demand

Enterprises in non-metropolitan areas ranked "low demand" on the top of the list. Smaller enterprises tend to regard low demand as more severe as compared with larger ones. Those located farther from urban areas seem to consider low demand more severely. Enterprises in non-metropolitan areas are more concerned with marketing issues of their products. In the JICA survey, some SMEs expressed their wishes to have guidance in terms of the market and customer information (8 SMEs out of 35) and marketing supports such as exhibition and trade fair (10 SMEs out of 35). Those who are the member of samity[21] and/or chamber of commerce

[20] EIU Bangladesh Country Profile 2008.

[21] A "Samity" is an association of people or group of people. It is mostly used in co-operative type of organization. It can be registered with Social Welfare, Co-operative department or with NGOs, or may be unregistered and informal.

and industry (CCI) replied information on market[22] as one of the reasons to join the organization.

Table 3-9: Percentage of enterprises in non-metropolitan areas that identify "low demand for goods and services" as major or severe investment climate constraints by size, sector and location

By sector and size

Sector	Less than 5 FTE workers	More than 5 FTE workers	Total
Manufacturing	49%	38%	48%
Trading	33%	13%	33%
Services	48%	19%	47%
Total	42%	31%	41%

By location

Peri-urban	Town	Village	Total
35%	41%	44%	41%

Source: ICA, 2008 (Appendix 10, Tables A 10.40 and A 10.41)
Note: FTE stands for Full Time Equivalent.

(5) Access to financing and high interest rates
Access to financing is one of the major constraints for enterprises in metropolitan areas while high interest rates for those in non-metropolitan areas. This will be described later in Chapter 4.6.2 when limited access to finance for SMEs is discussed.

(6) Low labor productivity
Aside from the above constraints, the ICA points out the low labor productivity as one of the key constraints. Despite high competitiveness of labor force in the Bangladesh's manufacturing sector and liberal labor regulations, labor productivity is low. About one fourth of the metropolitan firms explain an acute shortage of labor skills. The JICA SME Survey identified the low education level among workers at the respective firms. Out of the total number of employees at 35 SMEs, about 54 % was graduates of primary schools and 22 out of 35 SMEs responded that they wished to receive guidance in terms of workers' training.

3.3 SME Promotion Policy

This section describes how the Government of Bangladesh has mainstreamed the SME policy in their efforts of reducing poverty while accelerating the economic growth. In the process, SME Foundation was established as an independent apex body for SMEs in order to implement the SME policy and facilitate development of SMEs from a viewpoint of management in the private sector. In March 2010, a new SME policy was announced by BB, which showed a more integrated approach toward SME development. In the draft Industrial Policy 2010, BB's refinance schemes are regarded as measures to address market failures.

3.3.1 Industrial and SME policies[23]

The role of SMEs as engines for growth, employment, and poverty reduction has been recognized globally, in particular since 2000s. At the same time, the need to design SME

[22] 12 SMEs out of 16 that replied for samity and 11 SMEs out of 15 for CCI.
[23] In describing this section, various documents relating to ADB-assisted SMESDP have been referred to.

policies in the context of a coherent and integrated approach to economic growth and social development also was recognized.

In line with above-mentioned global consensus, in November 2003 the government of Bangladesh established the national task force on development of SMEs (the SME Task Force)[24] in order to draw up a realistic strategy for promoting rapid growth and vigorous competitiveness among SMEs in the interest of accelerating the growth of the economy and the reduction of poverty in the country. The SME Task Force made the recommendations[25], which formed the basis for Industrial Policy 2005, to the Economic Affairs Committee of the Cabinet. In January 2005, the Cabinet approved the Industrial Policy 2005, which identifies SMEs as an important sector for sustainable industrial development in the country.

SME related policies and strategies consider the smooth and sustainable development of SMEs all over the country as one of the vehicles for accelerating national economic growth, including poverty alleviation, the reduction of unemployment, and the generation of more employment. This is in line with core principles and parameters set by the Poverty Reduction Strategy Paper (PRSP) of 2004 as well as targets set under the Millennium Development Goal (MGD).

Having faced the challenges of the free market economy and global competition, Industrial Policy 2005 identifies the important role to be played by the private sector for the country's industrialization while the Government acts as a facilitator. In order to reduce poverty and generate employment opportunities, the Industrial Policy considers it necessary to establish agro-based industries and to raise agricultural production. For the creation of further employment opportunities beyond the agricultural sector, initiatives should be taken to set up SMEs and large industries across the country.

The policy states that the industrial sector is likely to grow over the next decade, with its contribution to GDP rising to 30 to 35 percent, while the workforce is expected to increase to 35 percent of the national employment need. In order to attain this growth in this sector, special importance has been given to agro-based and agro-processing industries and to steps to overcome possible adverse conditions in the export-oriented garment sector. As for the SME sector, the Government regards SMEs as a priority sector and as the driving force for industrialization. The speedy expansion of cottage industries and SMEs, and further investment in these sectors are expected to contribute to a generation of new employment opportunities, the reduction of unemployment and the implementation of the poverty alleviation program. The Industrial Policy covers a number of issues and areas such as: the definitions and classification of industrial enterprises including SMEs, a list of the important sectors, the facilitating role of relevant ministries and public institutions in industrialization, privatizing of state-owned industries and the privatization commission, revenue and financial incentives, the participation and development of women entrepreneurs in industrialization, export-oriented and export linkage industries, foreign investment, industrial technology, technical and institutional assistance and so on.

The National Council for Industrial Development (NCID) chaired by the Prime Minister is empowered to take policy decisions under the umbrella of Industrial Policy 2005. Being responsible for SME development, NCID plays a leading role in achieving the Government's objective of establishing small, medium, and heavy industries on a massive scale throughout the

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[24] The taskforce was comprised of 16 members from the Government, academia and the private sector.

[25] Key components of the recommendation are the declaration of SMEs as a priority sector, an institutional framework, various incentives, and capacity building and human resource development measures (ADB, Report and Recommendation of the President to the Board of Directors on Proposed Loans and Technical Assistance Grant to the People's Republic of Bangladesh for the SMESDP, 2004).

country and expeditiously resolving problems in the industrial sector. The Government set up an SME Advisory Panel[26] to develop an action program to support SME development. On the basis of recommendations of the SME taskforce and the SME Advisory Panel, MOI formulated SME policy strategies.[27] In January 2005, MOI's SME Cell[28] issued policy strategies for the development of SMEs[29], which were made public separately to Industrial Policy 2005.

The SME policy strategies in 2005 stated that the over-riding vision must be for the setting-up of a market-based economic order with a level playing field for all enterprises. While the country has faced the challenges of the free market economy and globalization and accelerated trade liberalization has become a necessary condition for creating an enabling environment for the broad-based growth of manufacturing industries, the policy strategies recognize that SMEs will require a well targeted assistance package, especially in terms of credit availability, skills-up and mentoring on how to make most of the opportunities that an outward-looking regime of trade and industrial policies can unleash. The policy strategies for development of SMEs in 2005 identified a number of policy measures to be taken for SMEs. The policy measures range from revenue and fiscal incentives to credit distribution and venture capital market, quality assurance certification, multi-stage sample survey of SMEs, tactical plan of action,[30] formulation of a package of capacity-building and training, evolving of an SME eco-system, mitigating impediments in clusters and educational and generational ethos. ADB assisted program loan (SMESPD) facilitated SME access to various services along with these policy measures. The following shows some of policy measures presented in the SME policy strategies together with some of the policy measures being taken.

Table 3-10: A set of policy measures presented in the SME policy strategies 2005 with concrete examples

Policy measures	Some of the concrete measures being taken
Revenue and fiscal incentives	The Government has given a tax holiday to 19 subsectors, ranging from 4 to 6 years. It is also extending production level tax rebates to small and cottage industries located in less and least-developed areas of the country. Almost every year the Government reviews the prevailing economic conditions and raises the filing threshold for tax purposes, which act as a tax incentive for SMEs (ADB: 2008)
Credit distribution and venture capital market	The distribution of the credit from BASIC bank, Brac bank, etc. Donor financial resources were made available to SMEs under the refinance scheme of BB. A wholesale program was launched by SMEF. Supports from the Equity and Entrepreneurship Fund (EEF) were continued.
Quality assurance certificate	Promulgation of the accreditation law, establishment of Bangladesh Accreditation Board
Multi-stage sample survey	Sample survey of about 4000 enterprises
Tactical plan of action	Design and development of SME web portal at SMEF

[26] The SME Advisory Panel consists of representatives from MOI and other ministries concerned, industry associations, and the private sector.

[27] Policy, guidelines, strategies, implementation mechanism, and action plans for the development of SMEs are collectively referred to as SME policy strategies in this context.

[28] SME Cell was set up by MOI to implement SME policy strategies and the Government's program and activities for SME development. The articles of association of SMEF stipulate that the existing SME Cell will be merged in the secretariat of the SMEF.

[29] MOI, Policy strategies for SME development in Bangladesh, Jan 2005.

[30] The tactical plan of action includes strategic plan of action, enabling environment, supply chain for technopreneurship, SME Web portal, a virtual SME front-office and so on.

Policy measures	Some of the concrete measures being taken
Formulation of a package of capacity-building and training	Entrepreneurship training programs conducted by the Small and Cottage Industries Training Institute (SCITI).

Source: SME policy strategies (2005), ADB, Progress Report on Tranche Release (2008), ADB, Report and Recommendation of the President to the Board of Directors: Proposed Loan: People's Republic of Bangladesh: SMESPD (2009), and interviews at MOI and other organizations in Mach, May and June 2010.

With regard to the credit distribution and venture capital market in the table above, the SME policy strategies regarded the BASIC bank, one of the specialized banks (SBs), and BRAC bank, a PCB, as the lead banks in the short run. These lead banks were tasked to distribute the credit fund and venture capital fund. Over the medium term, this responsibility was planned to devolve to the SME Foundation under the said policy strategies. However, as described below and also in Annex 3, it is considered that SMEF is yet to be ready for extending credits on a larger scale although the Foundation started the wholesale program on a pilot basis. On the other hand, BB continues to play a role of managing three refinance schemes by use of its leverage as the central bank.

For promotional support, the SME policy strategies identified 11 booster sectors for public assistance in the next three years and provided policy recommendations for the short- medium and long-term. In selecting the 11 booster sectors, the strategies used the following criteria[31]: (1) strong comparative advantage; (2) rising demand; (3) backward and forward linkages; (4) non-existence of a level playing-field; (5) need for structural transformation; and (6) structure of incentives for manufacturing over trading. The following table shows a list of the 11 booster sectors together with the criteria being applied.

Table 3-11: Booster industries identified under the SME policy strategies in 2005 with selection criteria

Criteria for targeting (Note1) / Sector	(1)	(2)	(3)	(4)	(5)	(6)	(Note2)
Electronics and Electrical		X	X				Intensively requires innovation
Software Development		X			X		Intensively requires innovation
Light Engineering			X				Natural survivability
Agro-processing and related business[Note3]	X	X	X				
Leather and Leather goods			X				
Knitwear and Ready Made Garments	X	X					
Plastics and other synthetics		X					
Healthcare and Diagnostics		X			X		
Educational Services		X			X		
Pharmaceuticals/ Cosmetics/ Toiletries		X			X		

31 The Policy Paper 0806 of BB points out that "much of the high productivity growth of SMEs would come from firms with robust potential for productivity growth and sub-sectors with significant subcontracting activity". 11 booster sectors were identified for this purpose.

Criteria for targeting (Note1) / Sector	(1)	(2)	(3)	(4)	(5)	(6)	(Note2)
Fashion-rich personal effects, clothes and consumption goods.							Natural affinity to female-centric entrepreneurship

Source: Prepared based on the SME policy strategies 2005 by MOI.

Note 1: Criteria of sector targeting are set as follows: (1) strong comparative advantage; (2) rising demand; (3) backward and forward linkages; (4) non-existence of the level playing-field; (5) need for structural transformation; and (6) structure of incentives for manufacturing over trading

Note 2: The SME strategies do not mention what these statements mean, but these may indicate criteria or additional explanation to the criteria.

Note 3: Agro-processing/agri-business/plantation agriculture/specialist farming/tissue culture.

The new Industrial Policy 2010 is under preparation. According to MOI, the new policy is different from the existing Industrial Policy in the sense that emphasis is placed not only on the role of the private sector but also on public-private partnerships in consideration of the role of the public sector[32].

The draft Industrial Policy 2010 that the JICA Survey Team obtained in May 2010 incorporates definitions of SMEs, women entrepreneurs, priority/trust sector industries (Annex 2: Priority Sectors (important sectors) list), etc. In the draft Policy, part of SME development is included in Chapter 6: Development of Small, Medium, Micro and Cottage Industries. According to the draft, the Government regards SMEs as “a wheel to achieve living standards of the people, economic growth, and poverty alleviation” and assigns to the Government the following prime responsibilities: the removal of bottlenecks in the policy and regulatory frameworks and assistance in improving the market failure of products. The draft specifically mentions that the Government is to perform the following functions:

(1) Supply of adequate loans and motivation for SME entrepreneurs through training and development; continuing strengthening of these activities;
(2) The Bangladesh Bank will continue to support programs of refinancing under the three Funds created to refinance SME;
(3) Women entrepreneurs will be given priority in loans consideration. At least 15% of the total allocation in this sector will go to women entrepreneurs. The rate of interest in this case will be 10%
(4) ITC industries will be assisted in growth on a priority basis.

With regard to issues relevant to SME loans, the draft policy mentions the problems of access to finance by small enterprises that need to be resolved to create opportunities to sanction loans without collateral.

Aside from the Industrial Policy 2010, the “Strategies for Small and Medium Enterprises (SME)” will be separately prepared in 2010, in which all policies and regulations adopted by the Government on SMEs will be given in detail. According to a notification issued on March 31, 2010 by the SME Cell of the Ministries of Industries, the National Task Force for Development of SME had been reconstituted. The task force consists of 19 members with the principal secretary of the prime minister’s office being a convener. One of the tasks of the SME Task Force is to amend and update the SME policy strategies of 2005. At the first meeting of the SME Task Force held on May 2, 2010, the SME Policy Committee was established to amend the SME Policy Strategies by end of July 2010. The amendment is planned in such a way that

[32] Interview at MOI on March 14, 2010. According to MOI, BB’s refinance scheme, which use PFIs to extend sub-loans to SMEs, are considered as one form of PPP.

uniform definitions of SMEs will be adapted and SME Policy Strategies be formulated in line with the Industrial Policy 2010[33].

3.3.2 SME Foundation

The SME Foundation (SMEF) was incorporated in 2006 as a company limited by guarantee and licensed under Section 28 (an association not-for-profit) under the Companies Act, 1994. It is seen as an independent apex body for SMEs. The Foundation started to function from July 2007 with its own fund. The object of SMEF is to maintain consistency with PRSP under implementation by the Government, to establish SMEs and to alleviate poverty, reduce unemployment and create more employment and above all to help earn national economic growth by sustainable industrialization.[34] The memorandum of association specifies that the Government entrusts SMEF with the implementation of SME policy, strategy and guidelines adopted by the Government. The management of SMEF is represented by the private sector. According to the articles of association, the Board of Directors consists of 16 members including three members from SMEs, two members from civil society and technical universities, three members from members of SMEF in the private sector and a managing director (non-voting) from the private sector.[35] The managing director was newly appointed in March 2010, and 14 members are currently sitting at the board (FY 2009-2010 Session (3)), out of which personnel from the private sector and academic institutions account for more than 50%. (Annex 3 describes aspects relating to finance and organization, wholesale program of SMEF)

3.3.3 SME Policy of BB

BB has taken a number of measures to support the development of SMEs in Bangladesh. These measures include:

1) Issuance of the first BB SME Policy on March 26, 2010
2) Establishment of a separate SME Special Programmes Department at the end of December 2009
3) Issuance of prudential guidelines for financing small enterprises;
4) Provision of necessary orders to distribute targeted amounts of credit;
5) Priority given to small entrepreneurs;
6) Provision of refinancing schemes for industries (manufacturing) and service sector development;
7) Orders to open a dedicated SME help desk for all bank/financial institutions;
8) Approved opening of SME service centers;
9) Approval for opening of SME/Agriculture branches;
10) Agreement for a unified and unanimous definition;
11) Use of outsourcing channels[36] in SME credit distribution, monitoring, and loan recovery;

[33] Interview at MOI on May 5, 2010. It was heard that the SME Policy Committee would be chaired by the chairman of SME Foundation.

[34] SMEF, Annual Report 2008-09. In the medium-term policies, the SME policy strategies 2005 state that "[W]hile the Ministry of Industry will still remain the sovereign source of all policies, the proposed SME Foundation will become the focal point for all planning, developmental, financing, awareness-raising, incubation, advocacy, monitoring and evaluation services in the name of all SME development as a crucially-important element of poverty alleviation."

[35] One of the second tranche release conditions under the ADB-assisted SME Sector Development Program (SMESDP) is the Government approval of the memorandum and articles of association for the setting up SMEF with at least 50% private sector representation on the board and a chief executive officer from the private sector to assume the responsibilities of implementing the SME policy from the SME Cell and to take over the management of SME credit facilities directly administered by the Government.

[36] Banks can disburse SME loans through linkages with private voluntary organizations such as NGOs and self-help groups.

12) Tenure of scheduling of loan payment extended for medium industries
13) Orders for credit in IT and the broadband sector.

Among these policy measures, the following three measures are considered to be closely relevant to the proposed project: 1) the new SME policy; 2) the refinancing scheme; and 3) the increase in the outreach for SME finance. Details of the three measures are explained in Chapter 4.5.3 Policies on the Financial Sector for SMEs.

4. Financial Sector for SMEs in Bangladesh

4.1 Financial Sector in Bangladesh

4.1.1 Current Situation of Financial Sector

(1) Financial System in Bangladesh

The financial system of Bangladesh consists of Bangladesh Bank (BB) as the central bank, four (4) state-owned commercial banks (SCBs), five (5) state-owned specialized banks (SBs)[1], 30 domestic private commercial banks (PCBs) including seven (7) Islamic banks, nine (9) foreign banks (FCBs) and 29 non-bank financial institutions (NBFIs). In addition, licenses have been given to 298 Micro-credit Organizations. The financial system also embraces insurance companies which number 62, out of which two (2) are government owned and 60 privately owned. There are two stock exchanges in Dhaka and in Chittagong and a significant number of co-operative banks.

(2) Structure and Performances of Banks and NBFIs

The following table shows the structure of the banking sector as officially released by BB as of December 2008:

Table 4-1: Structure of Banking System (as of December 2008)

%, Tk billion

	No. of Banks	No. of Branches	Total Assets (Tk billion)	% of Total Banking Industry	Deposits (Tk billion)	% of Total Banking Industry
SCBs	4	3,386	1,030.9	31.1	758.8	29.7
SBs	5[*1]	1,362	222.3	6.7	137.8	5.4
PCBs	30	2,082	1,794.5	54.2	1,450.7	56.6
FCBs	9	58	265.8	8.0	214.1	8.4
Total	48[*1]	6,886	3,313.5	100.0	2,561.4	100.0

Source: Bangladesh Bank, "Annual Report 2008-09"

Note: Due to a merger taken place in January 2010, the numbers of the SBs and the Total decreased to 4 and 47 respectively.

The banking sector has evolved since 1985-90[2] as follows: (i) the total number of scheduled bank branches has increased from 5,042 at the end of December 1985 to 6,886 at the end of December 2008; (ii) the aggregate amount of assets held by SCBs declined substantially to 31.1% of the total assets of the banking industry against 54.4% in 1990 while the PCB share rose to 54.2% in 2008 from 22.6% in 1990. The FCBs held 8.0% of the banking industry assets in 2008, showing a negligible increase of 0.03% over its share in 1990.

Among the SBs, Bangladesh Shilpa Bank (BSB) and Bangladesh Shilpa Rin Sangtha (BSRS), which extended term loans to the industrial sector merged to form a new bank named Bangladesh Development Bank Ltd., which started its operation in January 2010. In accordance with the BRPD Circular Letter No-01 dated January 3, 2010, BSB and BSRS have been excluded from the list of scheduled banks.

[1] Due to a merger taken place in January 2009, the number decreased to and remains to be 4 as of today.

[2] Mr. Habibullah Bahar, Economic Advisor to Bangladesh Bank, "Financial Liberalization and Reforms in Bangladesh", lecture delivered at National Workshop on Strengthening the Response to the Global Financial Crisis in Asia-Pacific of UNESCAP, held on December 9-11, 2009.

The NBFIs are comprised of investment and finance companies, leasing companies, and so on. NBFIs are regulated by the Financial Institutions Act, 1993 and other relevant rules. There are 29 NBFIs operating across the country, out of which one is government owned, 15 are privately owned local companies and the remaining 13 are established under joint venture with foreign partners. These institutions aggregated together, number 29 and account for about one percent of the total assets of the financial system. Their role in the financial sector is limited.

(3) Financial Institutions

1) Central Bank

Bangladesh Bank (BB), as the central bank, has legal authority to supervise and regulate all banks and non-bank financial institutions. It performs the traditional central banking roles of note issuance and of being the banker to the government and banks. Having been provided with the broad policy goals and objectives, BB formulates and implements monetary policy, manages foreign exchange reserves and lays down prudential regulations and conducts monitoring. Its prudential regulations include, among others; minimum capital requirements, limits on loan concentration and insider borrowing and guidelines for asset classification and income recognition. BB has the power to impose penalties for non-compliance and also to intervene in the management of a bank if serious problem arises. It also has the delegated authority of issuing policy directives regarding the foreign exchange regime[3].

The Bank Company Act, 1991, empowers BB to issue licenses to carry out banking business in Bangladesh. Pursuant to section 31 of the Act, before granting a license, BB needs to be satisfied that the following conditions are fulfilled: "that the company is or will be in a position to pay its present or future depositors in full as their claims accrue; that the affairs of the company are not being or are not likely to be conducted in a manner detrimental to the interest of its present and future depositors; that, in the case of a company incorporated outside Bangladesh, the Government or law of the country grants to the banking companies incorporated outside Bangladesh and that the company complies with all applicable provisions of the Bank Companies Act, 1991." Licenses may be cancelled if the bank fails to comply with above provisions or ceases to carry on banking business in Bangladesh[4].

2) State-owned Banks

Both SCBs and SBs are owned by the government and constitute the state-owned banks. SCBs maintain an extensive branch network that covers not only the urban areas but also the rural areas of the country. The number of branch counts as many as 3,386 for the four banks which averages at 847 branches per a bank. SBs, too, maintain a large number of branch offices, 1,362 in total averaging 272 branches per a bank. There exists no explicit demarcation of business between SCBs and SBs. Only the historical background of each bank characterizes them as if being specialized in one or other particular industries. Both groups of state-owned banks are regulated under the same rules and regulations. SCBs and SBs have been recognized as having long-standing and serious problems as going-concerns. SCBs had been failing to meet the minimum capital adequacy requirement while carrying a high level of NPL ratios, though they are in the steps for recovery owing to the reform process. In particular, their loan portfolio for industrial term loan together with agricultural credit is embedded with chronic NPLs. Besides, SCBs used to be limited in the growth of their total assets under MOUs signed for reform process. Those factors combined used to place SCBs in a difficult position in expanding their portfolios for SMEs. Out of the four SCBs, Janata Bank is doing the best performance which reports NPL ratio standing at below 10% and capital adequacy ratio (CAR) exceeding the regulatory requirement.

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[3] Bangladesh Bank, “http://www.bangladesh-bank.org/”

[4] ditto

The problems identified for the state-owned banks are more serious at SBs. They have higher NPL ratios and lower CARs than SCBs. The type of institutions as a whole is debt ridden, i.e. the net worth being negative. The institutions are not self sustainable unless supported by the government. Among the five SBs existed as of December 2008, only one bank, BASIC Bank, is outperforming the industry whose activities for SMEs are conspicuous and noteworthy.

3) Private Banks

Both PCBs and FCBs constitute the privately owned banks. PCBs started to emerge in 1980s and gradually expanded its weight within the banking sector while SCBs and SBs had been suffering from chronic problems and inefficiencies. PCBs maintain smaller branch network than SCBs and SBs, focusing primarily the urban areas and their surrounding of the country. The 30 PCBs maintain 2,082 branch offices averaging 69 per a bank. The PCBs are noted for its higher management efficiency for more than several times expressed in terms of the per employee ratios. The FCBs count nine banks in total having 58 branch networks averaging 6 branches per a bank. Most of the FCBs maintain their head offices in foreign countries and operate in Bangladesh in branch status of the foreign banks. The FCBs' network is limited to be within the large cities through which they are obviously targeting much more efficient operation than the other types of financial institutions.

4) Non-Bank Financial Institutions

The NBFIs constitute a rapidly growing segment of the financial system. NBFIs are comprised of investment and finance companies, leasing companies, etc. NBFIs numbering 29 as of December 2008 are regulated by the Financial Institution Act 1993. The principal sources of fund for NBFIs are loans from banks and deposits from institutions and individuals. Deposits are allowed for the maturities of 6 months and longer but not allowed for shorter term[5]. NBFIs face comparative disadvantage in raising funds compared to the commercial banks as they are not covered by the Deposit Insurance System. Deposits at NBFIs are perceived to be less safe to the public and, as its result, NBFIs have to offer higher rates of interest on deposits. Excessive dependence on bank loan and deposits has an adverse impact on the general performance of industry. When interest rate goes up, the average rate of interest on bank credit lines and deposit rate goes up which causes significant rise in the cost of funds for NBFIs. NBFIs are allowed to participate in the call money market up to 15% of their total net assets. One cause of concern is recognized in NBFIs' maturity mismatch in funding. While the demand for long term funds are increasing as typically represented by the demand for leasing, the availability of long term funds remains inadequate as the funding of NBFIs is dependent on bank loans. The abundant liquidity existing in the call market seems alluring NBFIs to tap as their source of funding. The development of the call money market and activities of NBFIs are closely monitored by BB[6].

It has been reported that NBFIs are actively participating in the refinancing scheme offered by BB. As of the early date of August 2007, NBFIs had been consuming 49% of the total funds disbursed by 19 participating institutions. Although the NBFIs are increasingly coming forward to provide credit facilities for meeting the diversified demand for investment funds in the industrial sector of the country, the contribution of NBFIs to industrial finances still remains very small.

(4) Financial Markets

In the financial system, there exist different types of markets: i) interbank call market, ii) short term money market dealing the repo and reverse repo, iii) foreign exchange market, iv) government securities market (primary and secondary), v) stock market (primary and

[5] BB, Department of Financial Institutions and Markets

[6] BB FID Circular No.01 dated May 5, 2005 allows incumbent license holders of financial institutions to draw loan at 15% of their net assets from call money market in order to reduce high dependency on the call market.

secondary), and vi) national saving system. The following table shows the size of the markets as of the end of FY 2009 reported by BB:

Table 4-2: Size of the Financial Markets (as of June 2009)

Taka billion

Market	Product Traded	Outstanding Bal. /Market Cap.	Annual Turnover (FY 2009)
Interbank Call Market	Call Money		6,201
Short Term Money Market	Repo		1,935
	Reverse Repo		553
Government Securities Market	Treasury Bill Auction	132	243
	Treasury Bonds Auction	315	125
	Government Islamic Investment Bond	16	4
Foreign Exchange Market	Sold by BB		68
	Purchased by BB		102
	Interbank Dealing		304
Stock Exchange	Dhaka Stock Exchange	1,241	894
	Chittagong Stock Exchange	975	125
Other Saving System	National Saving Cert.	498	10 (net)
	Postal Saving		5 (net)

Source: BB, "Annual Report 2008-09", "Financial Sector Review" Vol. IV, No. 1, Jan. 2009 and "Bangladesh Bank Quarterly: October-December 2009"

Knowing that the nominal GDP of the country stands at Tk 6,149 billion and the total deposits of the commercial banks stand at Tk 2,787 billion as of the end of FY 2009, it is understood that the size of the financial markets as; government securities at 8% of nominal GDP and 17% of the banks' total deposits; stock exchanges at 36% of nominal GDP and 80% of banks' deposits. The turnover volume recorded in the interbank call market represents 2.2 times of the banks' deposits. The interbank call money is seen more active than repo and reverse repo as the former has been traded at about 2.5 times of the latter. The significant markets are reviewed in terms of their historical development as follows:

Table 4-3: Evolution of Financial Markets

%, Taka billion

Fiscal Year	2004	2005	2006	2007	2008	2009
Nominal GDP	3,330 (10.78%)	3,707 (11.32%)	4,157 (12.14%)	4,725 (13.66%)	5,458 (15.51%)	6,149 (12.66%)
Total Deposits of Banks	1,213 (13.79%)	1,426 (17.56%)	1,690 (18.51%)	1,970 (16.57%)	2,317 (17.61%)	2,787 (20.28%)
Volume of Call Money Dealt	2,123 (24.37%)	3,409 (60.57%)	5,397 (58.32%)	5,232 (-3.06%)	4,980 (-4.82%)	6,201 (24.52%)
Repo & Reverse Repo	502	642 (27.89%)	1,015 (58.10%)	2,950 (190.64%)	1,473 (-50.07%)	2,488 (68.91%)

Source: BB, "Annual Reports" various editions

Note: The percentages in the parentheses are the increases from previous years.

The primary features of the markets are observed as follows:

1) Interbank Call Money Market

The interbank call money market serves commercial banks and NBFIs in meeting their immediate liquidity needs and reserve deficiency. The volume of call money transacted kept faster increase than the growth of nominal GDP and total deposits of the banks by increasing 2.92 times between FY 2004 to FY 2009, whereas the nominal GDP grew 1.84 times and total deposits of the banks by 2.30 times.

2) Repo and Reverse Repo Market

BB uses the repo auction to provide adequate liquidity to the market against the collateral of T-bills and bonds. Vice versa, BB uses the reverse repo auction to control the level of liquidity in the market. The repo and reverse repo market has outgrown the call money market by expanding 4.96 times during the five years seen above.

3) Foreign Exchange Market

Under the current regime, banks and authorized foreign exchange dealers are allowed to deal in foreign currencies and the exchange rates can be quoted freely by those parties. The exchange rate is determined on the basis of demand and supply in the market. BB monitors the activities in the market and intervenes by buying and selling foreign currencies whenever it deems necessary to maintain the stability in the foreign exchange market[7]. In the foreign exchange market, the dealings among banks occupy the overwhelming share while that of BB intervention is limited in the absolute volume of transaction. The magnitude of the intervention by BB into the foreign exchange market has grown 7.9 times during the five years from FY 2004 to FY 2009.

4) Government Securities Market

T-bills and bonds are issued by BB on behalf of Government of Bangladesh in regular auctions. There exist nine primary dealers who act as the underwriters and market makers with commitments to bid in auctions. BB participates in the primary market for maintaining desired yield curve. BB used to issue its own bills of 30-day and 91-days during FY 2007 and FY 2008. The auction of BB bills, however, was discontinued in order to avoid their duplication with the similar maturities of T-bills in January 2008 for 91-day bills and in July 2008 for 30-day bills[8]. According to BB, the objectives for issuing these securities are two-fold; first, to use them as the tool to mobilize fund for financing government deficit as lower cost and second, to use them as a mopping up instrument of excess liquidity in the market[9]. The magnitude of the auction in T-bills and bonds grew by 3.3 times during the five years from FY 2004 to FY 2009. The government securities are mostly invested by the financial institutions which basically buy and hold the securities until maturity. The secondary market is virtually non-existent although Dhaka Stock Exchange maintains the registration of over 100 T-bonds listed for trading[10]. BB participates in the secondary trading of T-bills and bonds through over-the-counter dealing with financial institutions with a view to facilitating the market in working closely with other market participants. Despite the fact that T-bills and bonds are virtually free from default and considered to be the lowest risk financial instruments, the yield curve of interest rates were maintained in such a way that T-bond was yielding at 8.77% for ten year maturity as of May 2010 though the rate was the result of decline from 10.22% in May 2009. In May 2010, the majority of banks were offering interest rate of 8.00-8.50% for deposits of three years and longer. T-bonds are identified to be in direct competition with the fund raising of the financial

[7] BB, "Annual Reports 2008-09"
[8] BB, "Annual Report 2007-08" and "Annual Report 2008-09"
[9] BB, "Annual Report 2008-09"
[10] BB, "Financial Sector Review" Vol.IV, No. 1, Jan. 2009

institutions through medium/long term deposits. Not only in competition but financial institutions may have found the government securities as the attractive targets of investment while they are offered at a high level of interest with no inherent credit risk contained.

In addition to the issuance of T-bills and bonds, the government operates a National Saving Certificate System which offers relatively high interest rates of certificates for three and four years. The system mobilizes a significant amount of funds which are equivalent to approximately 8% of GDP in its outstanding balance. The rates of interest quoted by the system are 11.5% for three years and 12.0% for four years which are even higher than the yields of the treasury bonds of five year maturity. The system is in direct competition with the deposits taking activities of financial institutions in terms of its risk and interest rates offered to the depositors.

5) Capital Market

The capital market of the country is regulated by Securities and Exchange Commission (SEC). SEC ensures the compliance of capital market related laws, rules and regulations by the issuer companies, stock exchanges and intermediary institutions, etc. SEC also keeps surveillance on securities transaction and supervision on the market intermediaries so that the market operates in transparent manner[11]. SEC issues the list of registered merchant banks which are comprised of 31 institutions, out of which 29 are authorized for full-fledged merchant banking while one is permitted as the issue only manager and the other as portfolio only manager. It appears that the majority of the merchant banks are comprised of the subsidiaries of commercial banks belonging to different groups including three SCBs. The capital market is understood to be under the strong influence of banking institutions. The activities of those subsidiary merchant banks are under close supervision of BB with regard to the fund flows between the parents and the subsidiaries.

The capital market is composed of the primary and the secondary markets. The primary issuance of equity shares are conducted through public offering and through private placement. The listed securities are traded at the two stock exchanges; i.e. Dhaka Stock Exchange and Chittagong Stock Exchange. The numbers of listed securities at the exchanges are; 443 at Dhaka and 246 at Chittagong which are the result of growth 72% increase from 257 at Dhaka and 40% from 184 at Chittagong recorded in FY 2004 while a large number of those listed are dual listed at both exchanges[12]. Despite the global financial crisis, the two stock exchanges have recorded with rapid expansion of their total market capitalization while Dhaka Exchange grew by 8.7 times from Tk 142 billion in FY 2004 to Tk 1,241 billion in FY 2009 and Chittagong Exchange grew by 7.7 times from Tk 127 billion to Tk 975 billion during the same period[13]. While an impressive growth is acknowledged, the size of the market capitalization in comparison with GDP is still behind other SAARC nations. The ratios of market capitalization against GDP are reported by the World Bank for FY 2008 as; 8.4% in Bangladesh, 55.7% in India, 38.8% in Nepal, 14.3% in Pakistan and 10.7% in Sri Lanka[14].

6) Corporate Bonds

The corporate bond market is virtually non-existent in Bangladesh. It is reported that a total of 17 debentures were issued in the country since 1987 through public offering, out of which eight were outstanding as of December 2008, but the liquidity of those bonds was insignificant with

[11] BB, "Annual Reports 2008-09"

[12] ditto

[13] ditto

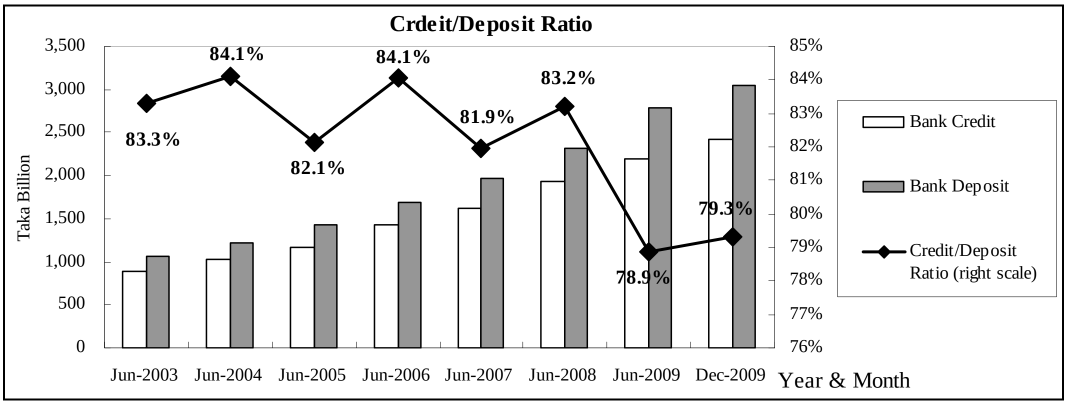
[14] World Bank, "World Development Indicators 2010". The World Bank denotes as the data source Standard & Poor's "Global Stock Markets Factbook 2009". World Bank under-reports the market capitalization of Bangladesh Stock Markets as USD 7.1 billion (Tk 488 billion) and the number of listed companies as 295. There appears a significant difference in the statistics on stock exchanges between BB and the World Bank.

negligible trading at the stock exchange[15].

4.1.2 Bank Credit and Deposits

(1) Lending and Deposits at Financial Institutions

The following figure describes the historical growth of bank credit and deposits:



Source: BB, "Annual Report 2008-09"

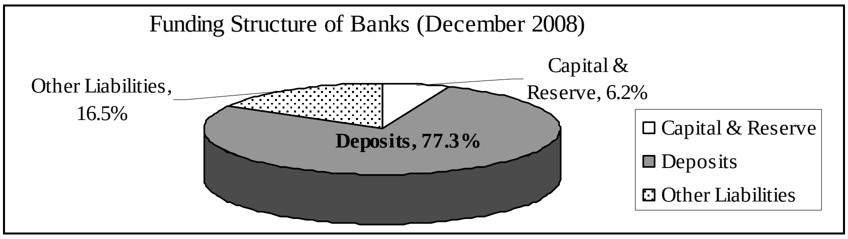
Figure 4-1: Credit to Deposit Ratio

The outstanding balance of bank credit[16] grew during FY 2004 through to FY 2009 by an annual average of 16.3% while the percentages of growth have varied between 13% and 21% with a comfortable margin over the growth rate of nominal GDP, which grew at an annual average of 12.7% during the same period. FY 2006 and FY 2008 were years when bank credit grew at the high percentages of 21.3% and 19.5% respectively, whereas other years than those mentioned saw moderate rates of growth at around 13-14%. Nominal GDP grew by 15.5% in FY 2008 which virtually matches the growth of bank credit. Bank deposits grew steadily at an annual average rate of 17.4% during the same period with varying percentages of between 13% and 20% outpacing the growth of bank credit and that of nominal GDP. The credit to deposit ratio has been moving within a narrow range of 82% and 84% during FY 2003 through FY 2008 but has moved out of the range to 79% in FY 2009.

(2) Fund Raising by Financial Institutions

1) Funding Structure

The banks in Bangladesh rely heavily on deposits. The following figure illustrates the funding structure of banks as of December 2008:



Source: BB, "Annual Report 2008-09

Figure 4-2: Funding Structure of Banks

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15 BB, "Financial Sector Review" Vol.IV, No. 1, Jan. 2009

16 Bangladesh Bank distinguishes the terminologies of credit, advance, bills purchased/discounted and investment to the effect that the credit is the collective representation of the three other terminologies and other non-funded facilities such as guarantee. The Chapter follows the distinction used by BB for those terminologies.

Banks are raising their funds from: equity 6.2%, deposits 77.3% and other liabilities 16.5%. No significant changes taken place in the structure of fund raising for the past several years. In December 2003, the ratio stood at equity 5.1%, deposits 75.3% and other liabilities 19.6%.

Liabilities other than deposits are primarily raised through borrowings from the central bank through the refinancing schemes and from other financial institutions via interbank transactions. With the exception of the refinancing provided by the central bank for medium/long term lending, the majority of the banks' borrowing is short term and does not meet the needs for raising of medium/long term funds.

2) Deposits

As previously seen, deposits have grown steadily at financial institutions that have sufficient funding for lending. Deposits are comprised of varying maturities of; current and savings accounts for maturity on demand; short term deposits; fixed term deposits for three months to several years; and pension scheme deposits for longer maturity. The following table gives the maturity-wise composition of deposits at financial institutions:

Table 4-4: Maturity Structure of Deposits *1

%, as of September 30, 2009

	SCBs	SBs	PCBs	FCBs	Total
Current & Saving	50.1	26.1	26.5	24.9	33.0
Short Term *2	10.5	6.6	7.1	17.0	8.8
Fixed Term <1 year *3	6.1	8.2	22.9	13.6	16.7
Fixed Term >1 year	25.5	46.7	28.8	29.1	27.9
Pension Scheme *4	4.7	11.2	9.4	1.1	7.6
Others *5	3.1	1.1	5.3	14.3*1	6.0
Total	100.0	100.0	100.0	100.0	100.0

Source: BB, "Scheduled Banks Statistics for July-September 2009"

Note: *1: includes foreign currency account of 6.7% and resident foreign currency account at 2.6%

*2: includes the deposits that are deposited for a period ranging from 7 days to 89 days and payable on special notice after a specified period.

*3: exclusively time deposits

*4: allows investors to deposit up to Tk 500 per month and with the requirement to continue depositing for a period of 10 years and 20 years.

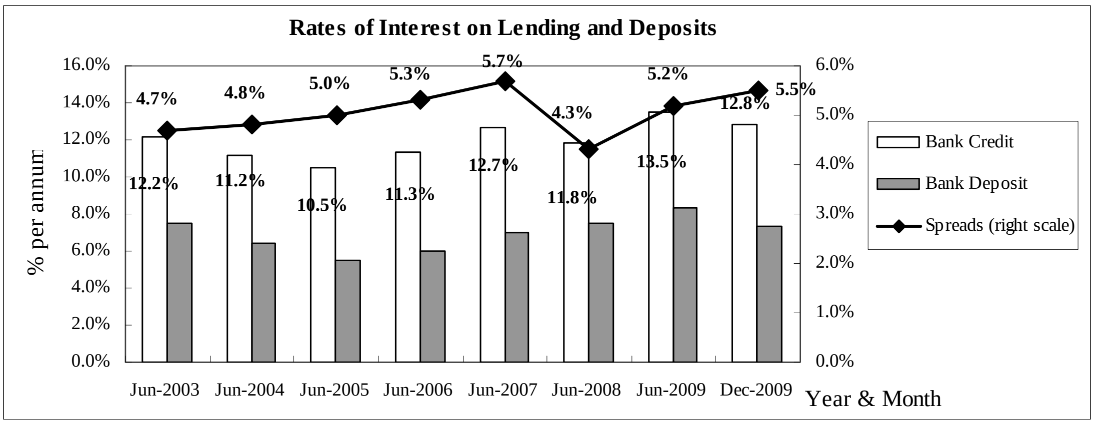
*5: includes deposits such as margin deposits, special purpose deposits, negotiable certificate of deposits, etc. which are of short term in nature.

For the whole banking sector, the maturity composition of deposits is seen as 33.0% on demand, 31.5% for short term including short term deposits, those of fixed term less than one year and others, and 35.5% for medium/long term deposits exceeding 12 months, including fixed term exceeding one year, and pension schemes. While a significant difference is observed in the maturity structure of deposits, all groups maintain medium/long term deposits exceeding 30%. Among the four groups, SBs have the highest percentage at 58% in the medium/long term deposit ratio, followed by PCBs at 38%, whereas SCBs and FCBs are parallel at 30%. It is imperative that financial institutions have the capability to raise the medium/long term funds to be mobilized with the comparable medium/long term lending activities.

One of the key issues that need to be addressed by banks is the maturity of their assets and liabilities. The option of business strategy exists for a bank to run a mismatch of funding maturity, i.e. to raise short term funds and lend long term in pursuit of higher profits. The low level of interest prevailing in the call market might allure the financial institutions to take advantage of the funds from the call market. Financial institutions must remain prudent in taking the risk. The mismatch is accompanied by liquidity risk which would put the bank into a vulnerable position regarding outside shocks and, therefore, banks are closely checked by the supervisory authority to make sure that they refrain from taking such a risky optional strategy. BB, under the regulatory guidance, mandates the financial institutions to conduct asset and liability maturity analysis as the core task of the asset and liability committee established at each of the financial institutions[17]. Under this regulation, banks conduct analysis comparing and verifying the adequacy of control over the gaps existing between the assets and liabilities for each of the blocks of maturities: i) up to one month, ii) one to three months, iii) three to twelve months, iv) one to five years, v) longer than five years, etc. BB mandates the financial institutions to disclose the results of such analysis to the public as an integral part of the financial statements. The risk positions taken by individual institutions will be reviewed and analyzed later.

(3) Rates of Interest

The figure posted below describes the weighted average rates of interest of the scheduled banks for lending and deposits along with the spread during FY 2003 to FY 2009. It is evident from the figure that the weighted average interest rate on deposits decreased during FY 2003 to FY 2005 but increased from FY 2005 to FY 2009 reaching to 8.3% in FY 2009. Throughout the period reviewed, the lending rate of interest has remained at a level exceeding 10%. The interest spread between the lending and deposit interest rates has also remained at the high level of 4 to 6%. The high spread stems obviously from the inefficiency in the management and the weakness in the financial intermediation function of the financial institutions. The problem of inefficiency is conspicuous among the SCBs which maintain a large number of branch network and employees whose productivities are measured considerably low in terms of such numbers as; the loan balance or the profits per an employee. The weakness of the financial intermediation function is typically recognizable in the phenomenon such as; low credit to deposit ratio or excess liquidity ratio. The rate of interest on lending has been on an upward trend since FY 2005, reaching 13.5% in FY 2009. Since FY 2009, BB has moved to cause the interest rate to decline by instituting such measures as installing a ceiling on the commercial banks' lending to priority sectors at 13% p.a. BB, at the same time, lowered its repo rate drastically when it resumed operation later in 2009. The lending rate took a downward trend from April 2009 but turned upward towards the end of 2009. The high spread between the lending and deposit rates is considered to be one of the causes pushing of the lending interest rate to the high level which has not come down despite BB's efforts to bring down the interest rates.

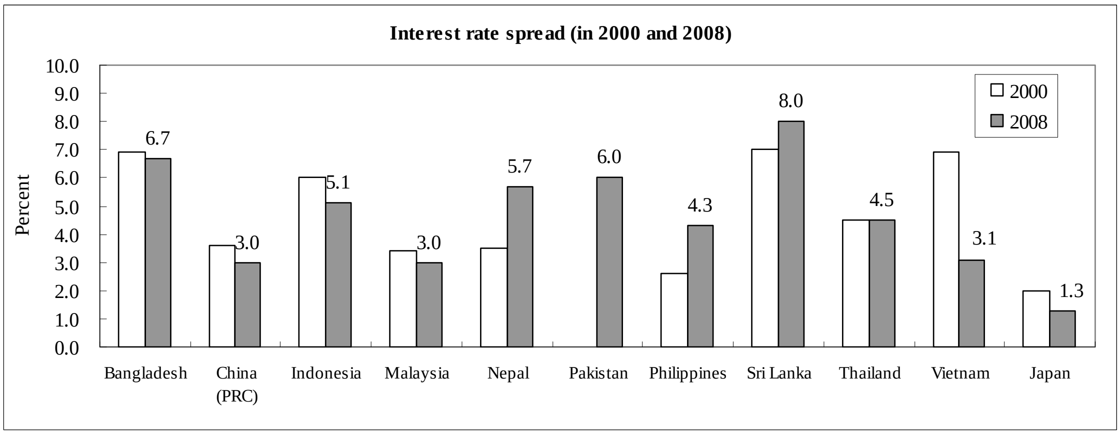


Source: BB, "Annual Reports 2008-09" and "Monthly Economic Trend" March 2010

Figure 4-3: Rate of Interest on Lending and Deposit

[17] BB, "BRPD Circular No. 17 dated October 7, 2003" and "Managing Core Risks in Banking: Asset-Liability Management", undated

The interest spread can be compared to those of the neighboring countries of the SAARC Region. The interest spread in countries in the region is 4.0-3.5% for India, 7.5% for Pakistan, 7.6% for Sri Lanka.[18] In addition, the World Development Indicator issued by the World Bank compares the interest spread among neighboring countries and its changes over the period from 2000 to 2008. Bangladesh is noticed of having a high spread of 6.7%[19] falling behind of all the countries compared with exception of Sri Lanka whose interest spread is 8.0%. The countries in ASEAN remain within the range of 3 - 5%.



Source: World Bank, "World Development Indicators, 2010"

Figure 4-4: Comparison of interest rate spreads among different countries

Apart from the banking deposits, the government operates a National Saving Certificate System which offers two categories of National Saving Deposit (NSD) certificates for three and four years. With the relatively high rate of interest, the system mobilizes a gigantic amount of funds which are equivalent to approximately 8% of GDP. For FY 2010, it is observed that the system absorbed Tk 28 billion in the first quarter alone[20]. The rates of interest quoted by the system are 11.5% for three years and 12.0% for four years which are even higher than the yields of the treasury bonds of five year maturity. The government rarely moves to change the issuing conditions of NSD whose issuing terms have been revised only four times during the past 10 years. The rigidity and the level of interest rates offered is recognized as affecting the interest rate setting of deposits at commercial banks.

4.2 Monetary Policy and Money Supply

4.2.1 Monetary Policy

(1) Objectives and Instruments

The National Strategy for Accelerated Poverty Reduction II (Revised) FY 2009-11 specifies the fundamental policy of the government in respect of the country's monetary policy and money supply, to the effect that "Bangladesh Bank will continue to pursue a monetary policy that will

[18] Data for India, Pakistan and Sri Lanka are as of January 2009. (BB, "Financial Sector Review" Vol IV, N0.1, January 2009)

[19] World Bank, "World Development Indicator 2010". World Bank denotes that the data on credit and interest rate are from IMF, "International Financial Statistics". IMF, "International Financial Statistics 2009" denotes that the deposit rate expresses the average rate offered by commercial banks on three to six month fixed deposits whereas the lending rate expresses the maximum rate charged by commercial banks on loans and advances for agricultural production, including forestry and fisheries.

[20] BB, "Bangladesh Bank Quarterly October-December 2009", Vol. VII, No.2

contain inflation at low levels and promote higher growth through the adequate flow of capital from banks to productive activities and refinance support to income and employment generating priority sectors including agriculture and SMEs, keeping the lending rate and interest spread low and maintaining a competitive real exchange rate"[21].

The objective of the monetary policy is to maintain price stability towards achieving the highest sustainable growth. As such, inflation and output growth are the basic policy targets. BB describes the monetary policy framework and the instruments to be used as follows[22]:

> BB uses the reserve money (operational target) program to target a growth path for broad money (intermediate target) consistent with the targeted rate of GDP growth and inflation. In pursuit of monetary policy instruments presently used by BB are: i) open market operation through repo, reverse repo and BB bills; ii) variation in reserve ratios; iii) secondary trading; iv) discount rate; v) moral suasion. Through open market operation, BB targets available liquidity flow in the market, routinely mops up excess liquidity and injects it as appropriate. The auctions of repo and reverse repo are generally held on daily basis. The variations in reserve ratios, i.e. Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR), which are primarily used to influence the quantity of credit available in the banking system, are used infrequently. BB conducts secondary trading as and when necessary.

(2) Cash Reserve Requirement (CRR)

By virtue of Section 25 of the Banking Company Act of 1991, scheduled banks are required to maintain Cash Reserves in deposits with BB for a stipulated percentage of their total demand and time liabilities (deposits) which have been set by BB at 5.0% since October 1, 2005. In 2009, CRR was amended to no less than 4.5% in any day with effect from March 1, 2009[23] but in May 2010, BB revised the CRR to be maintained at no less than 5.5%[24].

(3) Statutory Liquidity Requirement (SLR)

The demand and time liabilities for commercial banks are subject to a statutory liquidity requirement (SLR) of 18%, inclusive of an average 5 percent cash reserve requirement (CRR) on a bi-weekly basis effective October 1, 2005. The requirement was raised by BB to 18.5% in May 2010 together with the increase in CRR[25]. The CRR is to be kept with the BB and the remainder as qualifying assets under the SLR, either in cash or in government securities. SLR for the banks operating under Islamic Shariah is 10% and the specialized banks (except Basic Bank) are exempt from maintaining SLR[26].

4.2.2 Monetary Operation

(1) Repo & Reverse Repo

The actual performance of repo and reverse repo auctions during FY 2008-09 was reported by BB as follows:

[21] Planning Commission, Government of Bangladesh, "Steps Towards Change: National Strategy for Accelerated Poverty Reduction II (Revised) FT 2009-11", December 2009

[22] BB, "Annual Report 2008-09"

[23] BB, "Annual Report 2008-09"

[24] BB, "MPD Circular No. 01 on Cash Reserve Requirement" dated May 2, 2010

[25] BB, "MPD Circular No. 02 on Statutory Liquidity Requirement" dated May 2, 2010

[26] BB, "Annual Report 2008-09"

Table 4-5: Repo and Reverse Repo Auctions in FY 2009

	Total No. of Auctions	Bids Received		Bids Accepted		Interest Rates of Accepted Bids (% p.a.)
		No. of Bids	Face Value (Tk billion)	No. of Bids	Face Value (Tk billion)	
Repo	118	682	2,221	660	1,935	8.5-8.8
Reverse Repo	159	673	887	496	553	6.5-6.8

Source: BB, "Annual Report 2008-09"

The above table shows that both repo and reverse repo were conducted frequently during the year although their success ratios are not known. It has been discovered that BB was not successful in completing the auctions of repo and reverse repo during the last few months of the fiscal year. According to the BB's publication "Major Economic Indicators: Monthly Update", the actual rates for repo were reported in all the months up to March 2009 from when the record was suspended until August 2009, whereas the reverse repo rates were apparently suspended from April 2009 through September 2009. The achievement shown above is construed as the one that preceded such a suspension.

While BB maintains its monetary policy and instruments as above, there is the argument released by IMF with regard to the actual operation of the monetary policy and instruments offered by BB as follows[27]:

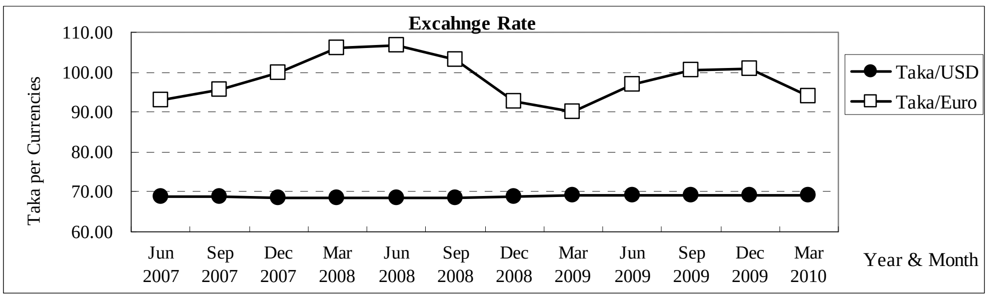
(i) Repo and Reverse Repo
The instruments are not used as standing facilities as BB reject banks' requests from banks at its discretion and as the interests is fixed by BB and rarely changed.

(ii) Securities
BB could issue securities for 30 and 91 days. BB has not issued any bills during last 18 months. Treasury bills are dedicated to Treasury cash flow management.

BB explains that it has discontinued issuance of BB bills for 30-days and 91-days in 2008 to avoid duplication with the similar maturities of T-bills[28]. BB clarifies that it is using the auction of T-bills as a tool for mopping up of the excess liquidity.

(2) Stabilization of the Foreign Exchange Rate

In contrast to the liquidity management, the monetary policy implemented by BB obviously pursued to maintain the stability of the exchange rates during past few years. The following figure illustrates the recent moves of the exchange rates:



Source: BB, "Bangladesh Bank Quarterly" and "Monthly Economic Update" latest editions

Figure 4-5: Management of Exchange Rates

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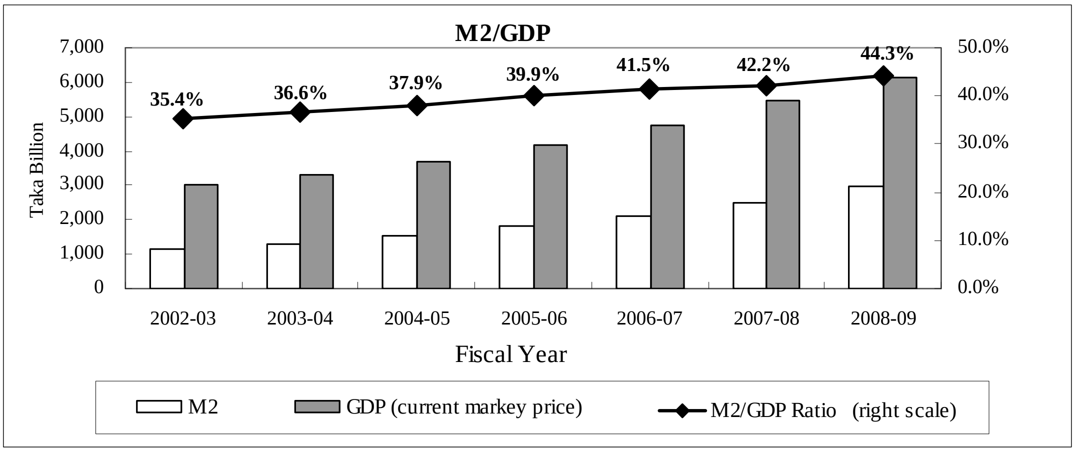
27 IMF, "Bangladesh: Financial System Stability Assessment", February 2010.

28 BB, "Annual Report 2008-09"

The above depicts the stability of the exchange rates, in particular of Taka against US Dollar, which is acknowledged to be almost in a flat line at or around the level of USD 1=Taka 69. In comparison to Taka/US Dollar, Taka/Euro saw fluctuation reflecting the fluctuation of Euro/US Dollar in the international market. BB explains the development of monetary policy and exchange rate management during FY 2009 to the effect that, the increase in workers' remittance inflows and slower outflow for imports resulted in swelling of BOP current account surplus and that the consequent appreciation pressure on Taka was checked by BB with continuous foreign exchange purchases to protect export competitiveness and to maintain incentive for inflows from workers abroad[29]. The explanation and the actual record of exchange rate movement endorses the fact that among the policy targets of the government and BB, actual execution of the monetary policy has placed priority on to the stability of exchange rates than the volume of money supply.

(3) Money Supply

BB's stance for easier monetary policy has resulted in the increase of the money supply. The following figure depicts the growth of broad money (M2) as against the growth of GDP (at the current market price):



Source: BB, Annual Report 2008-09

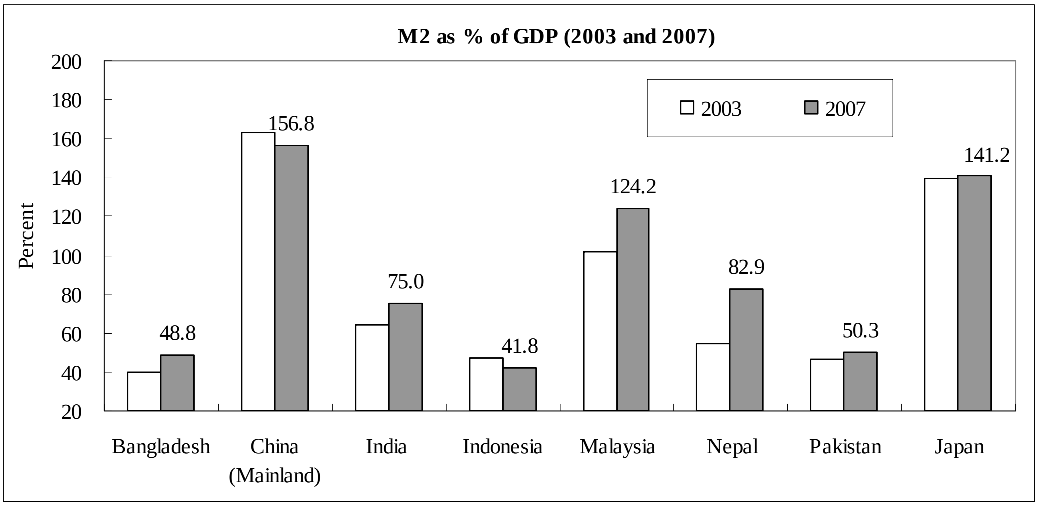
Figure 4-6: Broad Money (M2) / Nominal GDP

The above figure illustrates the progress of the financial deepening of the country which is obtained as the percentage of M2 (annual average) against nominal GDP. The ratio stood at 36.6% in FY 2004 but made a steady growth, reaching 44.3% in FY 2009. The ratio achieved can be compared to those of countries of the SAARC Region where it stood at 75.0% in India, 50.3% in Pakistan and 82.9% in Nepal in 2007. Bangladesh was trailing behind the fast growing economies of ASEAN such as Malaysia (124%), Thailand (110%), Vietnam (110%), etc[30] as of 2008[31].

[29] BB, "Annual Report 2008-09"

[30] IMF, "Article IV Annual Consultation Staff Reports" for respective countries

[31] With respect to the comparison of the financial deepening indicators, a caution is invited that the indicators may not appropriately represent the difference among countries of which the financial structures are significantly different. The comparison is understood to be effective among the countries having similar structure or within a country between time series.



Source: International Financial Statistics (IFS)
Note: Taken from M2 (59mb of IFS) except India where Money and Quasi Money (Line 35L) is used. The M2 is taken from the end of period data of IFS for easier comparison. IMF maintains different statistics on nominal GDP and such makes the difference of M2/GDP ratios between IFS and that of ours.

Figure 4-7: Comparison of M2 as Percentage of GDP among different countries

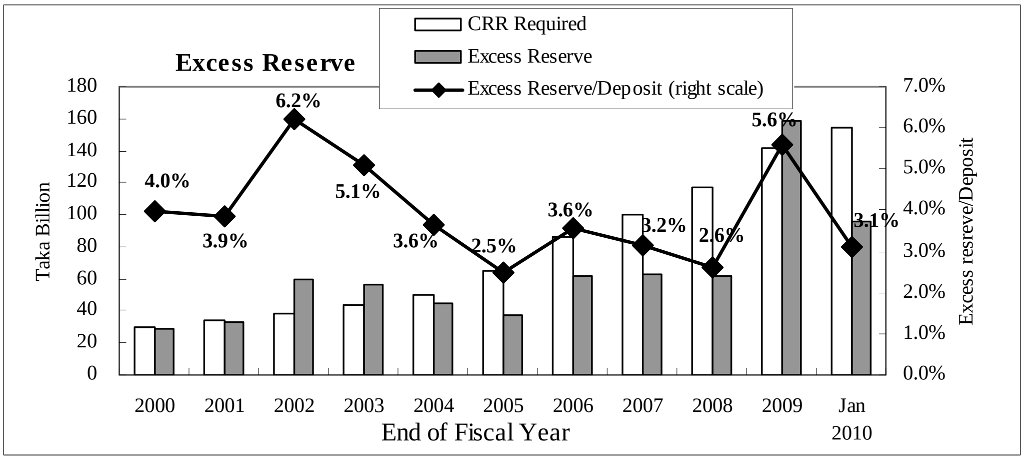
4.3 Excess Liquidity

4.3.1 Development of Excess Liquidity

BB follows the liquidity condition in the market through two indicators of the excess reserve and excess liquidity. The excess reserve is the commercial banks' cash and deposits kept at BB, less the required CRR, whereas the excess liquidity is taken from commercial banks' holding of liquid assets including the government securities less the required SLR. Commercial banks' demand and time liabilities (deposits) are at present subject to a statutory liquidity requirement (SLR) of 18%, inclusive of the average five percent (at least 4.5% in any day) cash reserve requirements (CRR) on bi-weekly basis. The CRR is to be kept with BB and the remainder as qualifying secure assets under the SLR, either in cash or in government securities. SLR for the banks operating under Islamic Shariah is 10% and the specialized banks (except Basic Bank) are exempted from maintaining the SLR. Liquidity indicator measured as the percentage of demand and time deposits of the banks indicate that all the banks carry a substantial liquidity in excess of what is required under the regulatory requirements[32]. The following figure describes the historical movements of the excess reserve ratio which is defined as balance deposited by the commercial banks at BB against their demand and time liabilities[33]:

[32] BB, "Annual Report 2008-09"

[33] BB calculates the excess reserve as the total balance of deposits of financial institutions at BB minus cash reserve requirement. (BB, "Major Economic Indicators: Monthly Update)



Source: BB, “Monthly Economic Trends” March 2010

Figure 4-8: Excess Reserve

4.3.2 Historical Background

It should be noted that the excess reserve ratio has made an abrupt surge to 5.6% in June 2009 reflecting the country’s easy monetary policy. The level reached then was a level close to that of June 2002. It would be worth while checking the background underlying the movement of the excess reserve during the period of 2000 and 2007 with particular attention to the evolution taking place in FY 2002 and succeeding years. The following table shows some of the indicators demonstrating the movement of the international economy, GDP growth, consumer prices and interest:

Table 4-6: Background to the Fluctuation in Excess Reserve

Fiscal Year	2000	2001	2002	2003	2004	2005	2006	2007
GDP (constant price: % change)								
World	4.76	2.53	4.05	3.78	5.11	4.66	5.03	
U.S.A.	3.66	0.75	1.60	2.51	3.64	3.07	2.87	2.19
EU	3.98	3.86	0.90	0.78	1.84	1.68	2.87	2.95
Asia	6.93	6.13	6.80	8.06	8.23	8.65	9.30	
Bangladesh*1	5.94	5.27	4.42	5.26	6.27	5.96	6.63	6.43
CPI (annual average: % change)								
World	4.3	4.1	3.4	3.6	3.6	3.6	3.5	3.8
U.S.A.	3.4	2.8	1.6	2.3	2.7	3.4	3.2	2.9
EU	2.2	2.4	2.3	2.1	2.1	2.2	2.2	2.1
Asia	1.5	2.4	1.9	2.5	4.0	3.6	3.7	5.0
Bangladesh*1	2.79	1.94	2.79	4.38	5.83	6.48	7.16	7.20
Interest Rate (disc. rate: % p.a.)								
U.S.A.	6.00	1.33	0.75	2.00	3.15	5.16	6.25	4.83
LIBOR (USD 3-month)	6.63	3.73	1.87	1.23	1.79	3.76	5.27	5.25
EU	5.75	4.25	3.75	3.00	3.00	3.25	4.50	5.00
Bangladesh *1	7.00	6.00	6.00	5.00	5.00	5.00	5.00	5.00
Bangladesh								
GDP Growth (nominal: % change)*1	7.91	6.94	7.75	10.02	10.78	11.33	12.14	13.65
M2 (annual growth in %)*1	18.6	16.6	13.1	15.6	13.8	16.7	19.3	17.1
Repo by BB (Taka billion)					231	233	53	11

Fiscal Year	2000	2001	2002	2003	2004	2005	2006	2007
Reverse Repo (Taka billion)					271	409	962	2,939
Current account balance (Taka billion)*1	-0.9	-43.3	14.0	11.4	30.1	-23.6	47.9	64.1
Remittance received (private: Taka billion)*1	98.1	101.7	143.8	177.3	198.7	236.5	322.7	413.0
Deposit Interest Rate (% p.a.)*1	8.64	8.85	9.12	7.51	6.38	5.51	5.77	6.51
Foreign Reserve (months of imports)	2.54	1.86	2.47	3.40	3.30	2.96	3.14	3.93
Exchange rate*1 (Taka/USD)	50.31	53.96	57.43	57.90	58.94	61.39	67.08	69.03

Source: IMF, "International Financial Statistics: Yearbook 2009"
*1: BB, "Major Economic Indicators: Monthly Update", March 2010
Note: Year represents the fiscal year of respective countries.

The above shows the background in the international economies that surrounded the excess reserve in Bangladesh during the period of FY 2000 and FY 2007. In September 2001, the September 11 incident occurred which affected the U.S. and international economy significantly. During 2001 and 2002, the U.S. economy took a sudden plunge which later affected the European economy, leading to a slump in 2002 and 2003. The U.S. GDP recovered its pre-2001 level in 2004. The slowing down of the GDP growth affected the CPI of the respective countries and areas. The CPI increase for the U.S.A dropped from 2.8% in 2001 to 1.6% in 2002. The slow growth of GDP and the low rate of inflation coupled together affected the level of interest rates in the respective countries and areas. The discount rate in the U.S.A. plunged from 6.00% in 2000, to 1.33% in 2001, and 0.75% in 2002. LIBOR took the same path ascending from 6.63% in 2000 to 3.73% in 2001 and 1.87% in 2002. In 2007, the prices of international commodities started soaring in involving the entire world into the inflationary pressure until it has reached for collapse in 2008 triggered by the sub-prime loan issues in the U.S.A. and subsequent financial crisis in the country and in other parts of the world.

Given the background, the economy of Bangladesh was affected moderately sending the GDP growth from 5.27% in 2001 to 4.42% in 2002. The CPI in Bangladesh was as high as 7.1% in 1999 but declined to 2.79% in 2000 and 1.94% in 2001. The monetary policies pursued by BB for each year of the above period have been checked in the Annual Reports for each year and are summarized as follows[34]:

i) FY 2000
World economy slowed down in 2000 and 2001, despite of which Bangladesh was successful to attain GDP growth at 5.9% during FY 2000. Inflation continued on the declining trend. The twelve month average of CPI declined to 2.8% in FY 2000. A moderately accommodative monetary policy was pursued during the fiscal year. For encouraging banks to provide loans to private sector, the bank rate was lowered by 1.0% from 8.0% to 7.0% in August 1999. Despite of the private sector credit being less than expected, M2 increased at a faster rate than projected.

ii) FY 2001
GDP grew at 5.3% in FY 2001 while inflation declined further to 1.9% from 2.8% in the preceding year. A moderately expansionary monetary policy continued in FY 2001 with the objective of maintaining dynamism in economic growth. The low inflation in spite of the

[34] BB, "Annual Reports" various editions

expansion in M2 was maintained at the cost of decline in net foreign assets. The country's external trade balance recorded deterioration during FY 2001 resulting in the decline in the foreign exchange reserve to 1.86 months of nation's imports.

iii) FY 2002
GDP growth slowed down to 4.4% in FY 2002. Bangladesh economy faced the challenge of sustaining growth while confronting with the internal imbalances of large budget deficit and accommodative monetary policy. The bank rate was lowered from 7.0% to 6.0% in October 2001. Inflation bottomed out in the first half of FY 2002 and slowly crept upward. The annual rate of CPI increase was 2.8% in FY 2002.

iv) FY 2003
The inflation continued the uptrend from preceding year. The annual average of increase in CPI was 4.4% in FY 2003. GDP growth started its recovery in recording 5.3% in FY 2003 up from 4.4% in FY 2002. The monetary policy maintained its accommodative stance.

v) FY 2004
The average rate of inflation intensified a rising trend in FY 2004. BB pursued cautious but accommodative policy to private sector credit demand. Repo and reverse repo were newly introduced. The growth in export and remittance was robust. Interest rate was on a declining trend aided by the lowering of the interest rate on the national saving certificate, reduction of SLR. The SLR was reduced to 16.0% in November 2003 from 20%. BB reduced the discount rate to 5.0% in November 2003.

vi) FY 2005
A rising trend of inflation continued in FY 2005 due to the increased food imports partly related to 2004 floods and the rise in some commodities in the international market. The monetary policy during the first half was accommodative to support flood rehabilitation and to maintain a low interest rate environment for enhancing the economic activities. During the second half of the year, tighter monetary policy was adopted due to the pressure on exchange rate. The policy change led the yield on T-bills and bonds, interest rates on repo and reverse repo to be raised gradually. CRR was raised from 4.0% to 4.5% in March 2005.

vii) FY 2006
The rising trend of inflation continued in FY 2006 due to higher prices of oil and some other imported goods. Depreciation of Taka associated with the balance of payment pressure added pressure on inflation. BB pursued a cautious and restrained monetary policy to curb excess demand from inflationary expectations. CRR and SLR were raised from 4.5% and 16.0% to 5.0% and 18.0% respectively in October 2005 The interest rates on T-bills, bonds, repo and reverse repo were maintained on sustained uptrend during the year in an attempt to slow down credit growth.

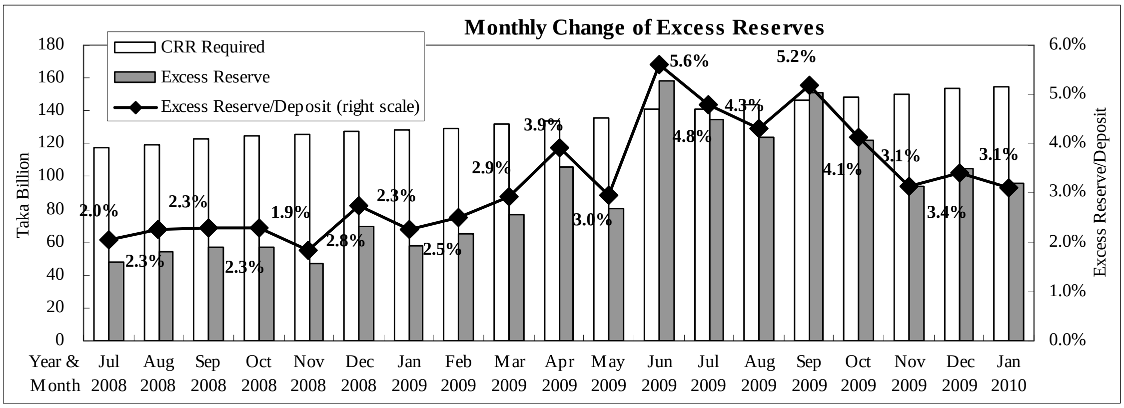
viii) FY 2007
The rising trend of inflation of FY 2006 continued in FY 2007 due mainly to higher prices of oil and some other imported goods. BB continued to pursue a cautious and restrained monetary policy to keep inflationary pressure under control. The T-bills, bonds, repo and reverse repo interest rates were maintained on sustained uptrend during the year in a continued attempt to slow down credit growth.

ix) FY 2008
The rising trend of inflation of FY 2007 continued throughout FY 2008. BB pursued growth supportive and prudent monetary policy to ease the uptrend in inflationary tendency. There was a sign for the lending rate among the banks to decline.

The above describes general overview of BB's monetary operation with underlying inflationary conditions. One of the important data contained in the above table is the record of repo and reverse repo in Bangladesh. Repo and reverse repo has been introduced to the monetary operation of BB in FY 2004. Since FY 2004 till FY 2007, it should be noticed that there was a substantial increase in the amount of reverse repo used as the tool for BB to absorb the liquidity in the financial market. To the contrary, there was not much volume witnessed in the repo transaction. BB intensified its monetary operation of absorbing the liquidity vigorously starting from FY 2004 and expanded its volume in FY 2005, FY 2006 and FY 2007. The volume absorbed in FY 2007 was about 6 times of FY 2004. The operation retreated in FY 2008 into less than half but revamped in FY 2009 by a significant magnitude. The operation by BB in increasing and decreasing repo and reverse repo is understood to have resulted in the increase and decrease of M2 for respective years.

4.3.3 Prevailing Condition of Excess Liquidity

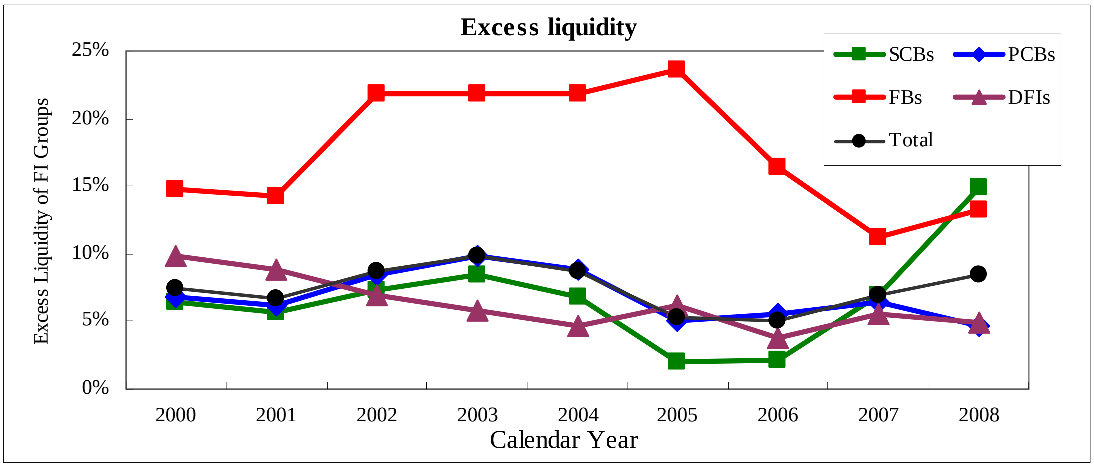
With exception of the two peaks recorded in FY 2002, FY 2003 and FY 2009, the ratios are observed to be in the range of 3.0-4.0% which is deemed as the normal. The ratio had been on the decline after the peak recorded in 2009 and came down to within the normal level at 3.1% in January 2010. To be more precise, the latest monthly changes in the ratio are indicated in the following figure:



Source: BB, "Monthly Economic Trends" March 2010

Figure 4-9: Monthly Changes of Excess Reserve

What is indicated in the above figure is that the excess reserve ratio stood below the normal level prior to March 2009. The ratio started climbing in March 2009 and jumped to the peak of 5.6% in June 2009 since when the rate took a declining trend till the latest month. It now appears that the excess liquidity is the issue in the past in the macro perspective, though there exist a significant difference among the groups and individual financial institutions. BB reports in its Annual Report 2008-09 the excess liquidity of financial institutions for each of banking groups as shown in the following figure:



Source: BB, "Annual Report 2008-09"

Figure 4-10: Excess Liquidity of Financial Institutions

The above figure shows that as of the end of December 2008, SCBs had the highest excess liquidity followed by FCBs at the end of December 2008. Conspicuous is the movement of the ratio of SCBs which used to be as low as 2.0% in 2006 but climbed sharply up to 14.9% in 2008 with the implication that SCBs accumulated an ample amount of liquidity for additional lending. Prior to 2008, FCBs used to be on top with respect to the excess liquidity. During the period between 2002 and 2005, the ratios were exceeding 20% but its position retreated to the second in ranking at the end of December 2008.

It should be noted that BB started moving vigorously to curb the inflationary pressure that became phenomenal since late 2009 until today. In addition to the daily operation of monetary adjustment, BB decided to raise CRR and SLR in Circulars dated May 10, 2010 by which CRR and SLR have been raised by 0.5% respectively, thus sending a strong message to the market.

With regard to the excess liquidity in the banking system, IMF points out to the effect[35] that the improvement in the current account of balance of payments put upward pressure on the Taka which BB countered through unsterilized foreign exchange purchases. This caused reserve money growth to accelerate to 32% in June 2009. Banks' excess reserves rose sharply and short term interest rates declined to below 1%. Already certain financial institutions have increased their dependency on short term funding, exposing themselves to the fluctuations of the money market.

4.3.4 Banks' Preference on Asset Selection

Earlier we have seen the prevalence of high interest rate on deposits and interest spread at financial institutions and the ceiling imposed on the interest rate on lending to certain economic sectors. Meanwhile the government securities are offering good opportunities for investment with relatively high yield. For financial institutions, various assets can be classified into the categories such as the government bonds being the assets of low risk and tolerable returns, whereas the loans to large enterprises are of medium risk and medium returns and those to SMEs are of high risk with high returns. The loans to SMEs that accompany high risk and high return should be worth pursuing if the return is sufficiently large to offset the risk. The ceiling imposed on the interest rate would cause the banks to refrain from lending to the regulated

[35] IMF, website "Bangladesh-2009 Article IV Consultation; Preliminary Conclusion of the IMF Mission", October 2009

sector, the medium sized enterprises, because the returns may not match the risks involved. Financial institutions may opt to invest the funds that could not be lent to those regulated sectors to other investment opportunities such as government securities causing the accumulation of excess SLR, though such is not proven.

4.4 Financial Sector Development

4.4.1 Government Policies for Financial Sector Development

The fundamental development policy of the government is documented in the National Strategy for Accelerated Poverty Reduction II (Revised) FY 2009-11. The policy stipulates promotion of higher growth through adequate flow of capital from the banks to productive activities as well refinancing support to income and employment generating priority sectors including agriculture and SMEs; also keeping the lending rate and interest spread low and maintaining a competitive real exchange rate[36]. The financial sector policy emphasizes greater efficiency in the financial sector especially in the banking system and NBFIs so that the interest spread is reduced, new and more productive financial products are introduced, the growth of financial assets is enhanced, risks are minimized, non-performing loans are reduced, etc. The prime goal of bringing better financial intermediation is to ensure the availability of the required pool of financial resources necessary to sustain smooth and adequate flow of credit to the economy. Concerns would be to maintain both the quality and quantity of financial intermediation through ensuring efficiency, credibility, transparency, and accountability.

4.4.2 Background of Financial Sector Reform

(1) Historical Development of the Financial Sector since Independence

The historical development of the financial sector in Bangladesh after her independence was presented at UNESCAP's Workshop in December 2009 by Mr. Habibullah Bahar, Economic Advisor to BB[37] as quoted in the following box:

BOX 4-1: Financial Sector Reform (presented by Mr. Habibullah Bahar, Economic Advisor to BB at UNESCAP Seminar)

In 1971 when the country became independent, the government nationalized the banking system. The East Pakistan branch of State Bank of Pakistan was converted into the country's central bank named as Bangladesh Bank with the multiple of objectives of; the sole authority to issue currency, keeping of the reserves and managing the monetary value, preserving the par value of the currency, fostering the economic growth. Under the Bangladesh Banks Nationalization Order 1972, with the assets of 12 privately owned commercial banks, six nationalized commercial banks were established. Moreover two specialized banks, Bangladesh Shilpa Bank and Bangladesh Krishi Bank were established in 1972 and 1973 respectively in succession of the assets confiscated from Industrial Development Bank of Pakistan and Agricultural Development Bank of Pakistan respectively.

With the gradual change in economic policy towards a more market based system, the government encouraged private sector banks to flourish in the country in 1980s. Accordingly, some of the private banks such as; Arab Bangladesh Bank, National Bank, IFIC Bank, and

[36] Planning Commission, Government of Bangladesh, "Steps Towards Change: National Strategy for Accelerated Poverty Reduction II (Revised) FT 2009-11", December 2009

[37] Mr. Habibullah Bahar, Economic Advisor to Bangladesh Bank, "Financial Liberalization and Reforms in Bangladesh", lecture delivered at National Workshop on Strengthening the Response to the Global Financial Crisis in Asia-Pacific of UNESCAP, held on December 9-11, 2009.

Islamic Bank Bangladesh have started their banking operation. Seeing the success of the new private banks, the government disinvested or transferred Uttara Bank and Pubali Bank to the private sector during 1984-85. Rupali Bank has also been transferred to the private sector in 1986. During 1990s, more commercial banks were allowed to participate in the sector.

Upon independence, the government adopted nationalization policy in almost every sector of the economy. The entire financial system was nationalized in accordance with the policy with the objective to support the priority sectors. Bank loans were mostly directed by the government to the public/state-owned enterprises. The policy eventually went into deep financial crises as most enterprises lacked commercial viability. The loan recovery was extremely poor as the deep-rooted structural problems lingered in the financial market and institutions throughput the country.

To overcome the problems, “National Commission on Money, Banking and Credit” was formed in 1984. The World Bank came in to assist the government to reform the sector. Following these initiatives, “Financial Sector Reform Programme (FRSP)” was formed and put into operation with the objective of removing the distortions and bringing competition into the financial sector in early 1990s. The main targets of FRSP were;

i) liberalization of interest rates,
ii) indirect monetary management,
iii) implementation of capital adequacy requirement of commercial banks,
iv) introduction of new policies for loan classification,
v) modernization of banking sector and introduction of updated accounting system,
vi) revision of the legal structure of financial sector,
vii) development of capital market,
viii) strengthening the central bank’s supervision,
ix) improvement of management of the banking sector with emphasis on credit management, and
x) computerization in the central bank and in the state-owned commercial banks.

Based on the findings and recommendations made by the National Commission on Money, Banking and Credit, the government adopted a number of reform measures since 1991 which responded to the each of the targets described above.

Meanwhile, the government enacted two important acts, namely, Financial Institution Act 1993 and Securities and Exchange Commission Act 1993 for the development of the non-bank financial institutions and the securities market.

In tandem with the progress of the efforts described above, IMF and the World Bank conducted Financial Sector Assessment Programme in 2002 in which the two institutions recommended that all the state-owned commercial banks be restructured to eliminate losses and ultimately sold off as a whole or in pieces[38].

The initial approach was taken by the government to address the problems through engagement of local firms to audit the SCBs. The special audits conducted revealed heavy NPLs totaling 43% of the SCBs’ loan portfolio and continued a sharp deterioration of NPLs and erosion in their capital base. The government took the measure to contain losses at SCBs by requiring all the SCBs to enter into MOUs with BB under which new lending was limited to 5% of their net portfolio at the end of FY 2003[39].

[38] IMF, “Bangladesh: 2003 Article IV Annual Consultation Staff Report”

[39] World Bank, “ Enterprise Growth and Bank Modernization Project” May 2004

In 2004, the World Bank followed a reform process with the provision of financial assistance - "Enterprise Growth and Bank Modernization Project" through IDA which contained two major components: i) provision of funds to BB for refinancing SMEs, and ii) supporting for financial sector reform. World Bank extended its assistance under the project that included; the privatization of Rupali Bank; employment of an external management team at Agrani Bank; and introduction of management teams at Sonali and Janata Banks to contain losses and improve the operation.

During the middle years of the 2000s, the government and BB were committed to the divestment of SCBs by establishing a strategy to the following effects[40]:

i) Overall goal: to improve the performance and divest SCBs,

ii) Memorandum of Understanding: BB and four SCBs signed MOUs setting a ceiling of 5% on annual growth in lending and a single party exposure to only 5% of the paid-up capital of each bank,

iii) Management of banks:
  - Rupali Bank: Financial advisor appointed and began working in June 2004,
  - Agrani Bank: An external firm took over management in October 2004,
  - Janata Bank: A team of external experts began to work for managerial assistance, and
  - Sonali Bank: External advisory team began working in August 2004.

iv) Goals to be achieved:
  - Rupali Bank: Divest majority ownership to private sector strategic partner,
  - Agrani Bank: Restructure, corporatize and bring to a point of divestment,
  - Janata Bank: Restructure, corporatize and bring to a point of divestment, and
  - Sonali Bank: Restructure, corporatize and bring to a point where a minority shareholding can be divested over the medium term.

(2) Execution of Corporatization

In realization of the established policies, the government proceeded to corporatize the SCBs with exception of Rupali Bank which had been corporatized earlier in 2007. The actual execution of corporatization took the processes that included steps such as: i) approval of Draft Memorandum and Articles of Association of the three banks for establishing limited companies in dissolution of the former government entities; ii) incorporation of the new public limited companies by the three banks; iii) application of banking licenses by the three banks and BB's approval under the Banking Company Act; iv) signing of vendor's agreements between the new company banks and Ministry of Finance, owner of the former SCBs containing the due diligence and valuation of the assets, liabilities and capital to be transferred. The vendor's agreements were signed in November 2007 which contained the provision that the government conceded a whole or a part of the accumulated deficit of the SCBs that had not been passed to the acquiring banks in the assessed value of the transfer. Upon the actual transfer of the assets, liabilities and capital, the accounting book entry was later discussed and agreed by the parties concerned including the regulatory institutions that the portion of the accumulated losses absorbed by the government was treated as the goodwill under the "Other Assets" that was determined to be amortized within the maximum of 10 years.

The process taken by the three banks can be verified through the actual reporting of the

[40] Fakhruddin Ahmed, Governor of BB, "Financial Sector Reform", March 2005

accounting treatment of the transfer in the annual report of Sonali Bank[41]:

> "Sonali Bank Limited took over the assets and liabilities of former Sonali Bank through a vendor's agreement executed between the Government of Bangladesh and Sonali Bank Limited on November 15, 2007 with retrospective effect from July 1, 2007. According to the decision dated March 24, 2008 of the representatives from MOF, BB, SEC and three SCBs, goodwill was created for issuing shares in the name of Government although there had existed accumulated loss of Tk 65,743,207,158 as on June 30, 2007. The accounting of accumulated loss was made by debiting the Intangible Asset-Valuation Adjustment under 'Other Assets' in lieu of Goodwill which would be gradually written off within the next ten years. During the year, a sum of Tk 3.5 billion has been adjusted by charging 'Amortization of Intangible Assets' in the Profit and Loss Account."

Similarly, Agrani Bank underwent the corporatization on July 1, 2007. The bank was granted the same treatment as to the disposal of the accumulated deficits. The bank's annual report explained the process of revaluation as follows[42]:

> "Agrani Bank Limited has taken over the entire assets and liabilities of former Agrani Bank through a Vendor's Agreement executed between the government and the Agrani Bank Limited on November 15, 2007 with retrospective effect from July 1, 2007. The asset and liabilities of Agrani Bank has been revalued by a professional Chartered Accountant firm to determine the final value. In determining the value, the valuation adjustment of the Bank has been calculated at Tk 13,295,881,639. A decision arrived among MOF, BB, SEC and the three SCBs that the valuation adjustment be shown under "Other Assets" and be gradually amortized within 10 years."

Janata Bank, on the other hand, did not go through the same process. Instead, the bank has being seen conducting the revaluation of its fixed assets twice, firstly in 1998 and subsequently in 2004. The revaluation increased the value of assets by Tk 961.7 million[43].

(3) Subsequent Development of SCB Reform

In accordance with the reform programs, the government corporatized three SCBs, Agrani Bank, Janata Bank and Sonali Bank in 2007. Rupali Bank had been previously converted into a public limited company. Prior to the corporatization, all the state-owned banks were placed under the regulatory and supervisory control of BB by moving them out of the direct control of the MOF. For execution of the conversion, the government established one each limited company for the three government owned banks. After corporatization, the boards of directors of the three SCBs were reconstructed and the power and accountability of the board was increased. All these four banks have signed MOUs with BB for improvement of their performances. The performances of SCBs are closely monitored under sets of indicators on a quarterly basis by BB.

The three SCBs thus succeeded to wipe out the accumulated losses and to reinforce their capital account during 2007. In the MOUs signed with BB, managements of SCBs have committed to achieve specific targets for each year. The targets adopted are; cash recovery of NPLs, operation, computerization, profitability, net worth, disclosure, etc. All the SCBs with exception of Rupali Bank are reported to have cleared the targets in 2008. MOUs were reportedly revised in June 2009 which relaxed some of the ceiling limits including the ceiling on the increase of loan assets to a certain extent allowing wider rooms of activities to SCBs.

Rupali Bank, on the other hand, was converted into a public limited company as early as 1986. Its shareholders are recoded as the government at 93% and private shareholders at 7%. During

41 Sonali Bank, "Annual Report 2007-08"

42 Agrani Bank, "Annual Report 2007-08"

43 Janata Bank, "Auditors' Report for 2006"

2006 and 2007, negotiations were conducted for selling the government held shares of the bank to an investor in Saudi Arabia. After lengthy negotiations, the deal was suspended and then cancelled. The government decided to remain as the shareholder of the bank. The government ordered the bank to virtually suspend the banking operation during the negotiations and the bank was allowed to resume its business in June 2009[44]. The abortive deal has placed the bank in a backward position in respect to financial restructuring and it still carries a huge amount of accumulated losses in its equity account.

As to the future course of SCB reform, there is no explicit indication given by the government of its ultimate goal. From the interviews conducted and the information obtained, the JICA Survey Team had the impression that the government remains complacent in maintaining the current position of the sole and/or overwhelming shareholders of the corporatized banks without having an intention for divestment.

(4) Expansion of Private Commercial Banks

The SCBs, once having dominated the market, has been grueling through the problems as described above and lackluster performance that has resulted in the constraints for expansion and loss of their market share to new market forces of PCBs and FCBs. IMF refers to the change of the market structure that had taken place during the transition and reform period in its Financial System Stability Assessment[45]. The change is summarized in the following table prepared from the Annual Reports of BB:

Table 4-7: Change of Market Shares

Taka billion

Calendar Year	Dec 2001			Dec 2008		
	No. of Banks	Total Assets	% of Total Assets held by Banks	No. of Banks	Total Assets	% of Total Assets held by Banks
State-owned Banks						
SCBs	4	511	46.5	4	1,031	29.7
SBs	5	105	9.5	5	222	5.4
Sub-total	9	616	56.0	9	1,253	35.1
Privately-Owned Banks						
PCBs	30	409	37.2	30	1,795	56.6
FCBs	10	86	7.8	9	266	8.4
Sub-total	40	495	45.0	39	2,061	65.0
Total	49	1,100	100	48	3,314	100

Source: BB, "Annual Report 2001-02" and "Annual Report 2008-09"

During the period between 2001 and 2008, the share of SCBs declined from 46.5% to 29.7%, whereas the share of PCBs increased from 37.2% to 56.6%. In comparison of the state sector and private sector, the state sector lost ground from 56.0% to 35.1% while the private sector expanded its ground from 45.0% to 65.0%.

(5) Statistical Performance of SCBs during Reform Process

The following table shows the performance of the four SCBs during recent years:

[44] Interview with Rupali Bank in March 2010.

[45] IMF, "Financial System Stability Assessment" February 2010

Table 4-8: Performances of SCBs

%, Taka billion

Calendar Year	2005	2006	2007	2008	2009	Ave
Sonali Bank						
Paid-up Capital	3.27	5.00	9.00	9.00	9.00	
Retained Earnings			0.78	2.95	4.03	
Revaluation Surplus			35.00			
Net Worth			21.74	24.42	30.48	
Total Deposits	277.08	302.30	329.00	364.39	406.15	
Total Loans & Advances (annual increase in %)	227.01 (+34.9%)	241.03 (+6.2%)	206.35 (▲14.4%)	231.17 (+12.0%)	254.02 (+9.9%)	(+9.7%)
L-T Loan Ratio (%) *1			62.60	46.45	42.70	
Loans to Deposits (%) *2	81.93	79.73	62.72	63.44	62.54	70.07
Capital Adequacy Ratio (%)			12.48	12.61	11.67	
Return on Assets (%)			0.96	0.33	0.42	
Return on Equity (%)			0.22	9.46	7.36	
Gross NPL (%)	22.52	24.44	44.59	31.44	27.49	
Maturity Matching (%) *3				141.92	130.72	
Janata Bank						
Paid-up Capital	2.59	2.59	2.59	2.59	5.00	
Retained Earnings		▲9.97	0.13	2.29	3.25	
Revaluation Surplus *4						
Net Worth	3.89	▲5.65	5.68	9.06	17.09	
Total Deposits	168.90	182.95	198.64	221.34	246.18	
Total Loans & Advances (annual increase in %)	123.47	138.49 (+12.2%)	121.20 (▲12.5%)	144.68 (+19.4%)	166.36 (+15.0%)	(+8.5%)
L-T Loan Ratio (%) *1			37.60	31.39	41.45	
Loans to Deposits (%) *2	73.11	75.29	61.02	65.37	67.58	68.47
Capital Adequacy Ratio (%)			6.59	9.62	13.57	
Return on Assets (%)		▲4.68	0.45	1.18	1.00	
Return on Equity (%)		-	2.27	35.17	17.58	
Gross NPL (%)			16.38	12.34	8.70	
Maturity Matching (%) *3			104.53	105.74	109.88	
Agrani Bank						
Paid-up Capital	2.48	2.48	2.48	2.48	4.97	
Retained Earnings	▲20.08	▲18.10	0.70	2.77	0.74	
Revaluation Surplus			13.30			
Net Worth	▲17.26	▲15.33	3.34	6.42	9.17	
Total Deposits	130.84	128.92	135.92	146.81	166.28	
Total Loans & Advances (annual increase in %)	99.40 (+3.6%)	105.87 (+6.51%)	118.49 (+11.9%)	113.36 (▲4.3%)	122.24 (+7.8%)	(+7.8%)
L-T Loan Ratio (%) *1			54.95	61.44	56.37	
Loans to Deposits (%) *2	75.98	82.12	87.18	77.21	73.51	79.20
Capital Adequacy Ratio (%)			5.90	9.16	10.80	
Return on Assets (%)	1.05	1.26	0.92	1.41	0.52	
Return on Equity (%)	-	-	29.55	41.28	12.09	
Gross NPL (%)	28.31	26.27	26.83	22.48	19.42	
Maturity Matching (%) *3				281.99	73.88	
Rupali Bank						
Paid-up Capital	1.25	1.25	1.25	1.25	1.25	
Retained Earnings			▲13.62	▲12.92	▲12.09	
Revaluation Surplus						
Net Worth			▲10.93	▲8.17	▲6.26	

Calendar Year	2005	2006	2007	2008	2009	Ave
Total Deposits	66.88	67.83	72.45	70.29	73.91	
Total Loans & Advances (annual increase in %)	44.92 (▲0.9%)	45.71 (+1.7%)	47.08 (+3.0%)	49.03 (+4.1%)	52.34 (+6.8)	 (+2.9%)
L-T Loan Ratio (%) *1			44.00	40.91		
Loans to Deposits (%) *2	67.17	67.39	64.77	69.76	70.82	67.98
Capital Adequacy Ratio (%)			▲29.66	▲17.58		
Return on Assets (%)			▲13.52	0.46	1.17	
Return on Equity (%)			-	1.06	2.40	
Gross NPL (%)			38.86	31.29	20.91	
Maturity Matching (%) *3				89.66	73.40	

Source: State Commercial Banks, "Annual Reports" various editions
Note *1: L-T Loan Ratio is the ratio of medium and long-term loans and advances to total loans and advances.
*2: Loans include advances
*3: Maturity Matching is the ratio of total assets excluding premises, fixtures and furniture whose maturity is longer than one year against the liabilities of the same maturity.
*4: Janata Bank: The fixed assets of Janata Bank were revalued twice, firstly in 1998 and subsequently in 2004, due to which the value of the assets increased by Tk 961.70 million.

The above table reveals phenomenal features in the performance of SCBs during the five years between 2005 and 2009. The points to be specifically noted are enumerated below:

1) Minimum Capital

The prudential regulation issued by BB requires the banks to maintain minimum capital of Tk 4.00 billion of which Tk 2.00 has to be maintained as paid-up capital. Banks having shortfalls are required to fulfill the shortfalls by August 2011[46]. All the SCBs but Rupali Bank have satisfied the requirement. Rupali Bank is falling short not only of paid-up capital but also of total capital while having paid-up capital at Tk 1.25 billion and negative equity of Tk -6.26 billion.

2) Revaluation Surplus

With exception of Rupali Bank, the three other banks exercised the revaluation of assets. Sonali Bank revalued its assets in 2007 for a surplus of Tk 35.00 billion, whereas Agrani Bank did the same in 2007 for a surplus of Tk 13.30 billion for cleaning up of accumulated losses for corporate restructuring. Janata Bank went ahead in revaluing its fixed assets in 1998 and 2004 for a surplus of Tk 0.96 billion. Rupali Bank was unable to do the same because of its aborted deal with a foreign investor for the sale of its shares and still carries the accumulated deficits in its capital account for the amount of Tk -12.09 billion.

3) Increase of Total Loans and Advances

While the increase of the total assets of each SCB has reportedly been contained under the ceiling limits specified in the MOUs, the actual performance of SCBs in total loans and advances are found varying not only among the four SCBs but year by year at each institution. Taking the average increase of the total loans and advances during 2005 through 2009, Sonali Bank increased its loans and advances at an average rate of 9.7% per annum, Janata Bank did the same at 8.5%, Agrani Bank did at 5.1% and Rupali Bank at 2.9%.

4) Medium- and Long-Term Loans and Advance Ratio

SCBs are noted for extending a significant percentage of their total loans and advances in medium and long-term loans and advances. For the year 2009 (Rupali for 2008), Agrani Bank led the SCBs in the ratio of medium/long term loans to the total lending at 56.37%, trailed by

[46] Previous regulation for minimum capital was for the amount of Tk 2.0 billion in the paid-up capital plus statutory reserve. Banks with shortfalls had to meet at least 50% of the shortfall by June 2008 and the rest by June 2009.

Sonali Bank at 42.70%, Janata Bank at 41.45% and Rupali Bank at 40.91%.

5) Loans to Deposits Ratio

The loan to deposit ratios among the SCBs also vary significantly. During the five years studied above, the average of the ratio of Agrani Bank ranked the first at 79.20%, while Sonali Bank followed at 70 07%, Janata Bank at 68.47% and Rupali Bank at 67.98%. The ratios of SCBs were somewhat higher during 2005 and 2006 but stayed at retreated levels in 2009.

6) Capital Adequacy Ratio

Supported by the reform process, particularly through the revaluation of assets and the setting of the performance indicators and the monitoring thereof, SCBs with exception of Rupali Bank are showing a phenomenal improvement in the capital adequacy ratios. While the prudential regulation established by BB requires financial institutions to maintain the capital adequacy ratio at or above 10%, Sonali Bank shows its capital adequacy ratios exceeding the required level during 2007 through 2009 at 12.48%, 12.61% and 11.67% respectively. Janata Bank was below the required level at 6.59% in 2007 and 9.62% in 2008 but surpassed the required level by jumping to 13.57% in 2009 which was the highest among the SCBs. A little later, Agrani Bank followed Janata Bank closely by recording 5.90% in 2007, 9.16% in 2008 and 10.80% in 2009. Three SCBs are now in clearance of the regulatory norm, whereas Rupali Bank again is falling far behind.

7) Earnings

The earnings of financial institutions can be measured by the two ratios of the return on assets (ROA) and the return on equity (ROE). Among the four SCBs, Janata Bank leads the group in the category of earnings by recording 1.00% for ROA and 17.58% for ROE. The performances of Sonali Bank and Agrani Bank are below the industry's average level and evaluated as low in respect of the prevailing rates of interest in the country. Rupali Bank is out of competition with other SCBs due to the negative net worth it carries.

8) Non-Performing Loans

Non-performing loans are the area in which SCBs are required to make accelerated efforts for eradication. The ratios were found to be 8.70% at Janata Bank, 19.42% at Agrani Bank, 20.91% at Rupali Bank and 27.49% at Sonali Bank in 2009. Though it has been observed that the ratios were reduced from their respective peaks, one should also note that the criteria for asset classification in Bangladesh are somewhat lenient compared to prevailing international practices and the ad-hoc measures announced from time to time by the regulatory authority for relaxation.

9) Maturity Matching

The financial institutions are required to disclose a liquidity statement in the format prescribed by BB in which the total assets and liabilities are classified into maturities of: i) up to one month, ii) one to three months, iii) three to twelve months, iv) one to five years, and v) longer than five years. The JICA Survey Team has aggregated the assets and liabilities exceeding one year to obtain a maturity matching rate of the assets and liabilities exceeding one year for each bank. The total assets thus aggregated excluding the premises, fixtures and furniture are divided by the aggregated liabilities of same maturity. The output obtained indicates to what extent banks are financing the long term assets by raising the matching maturity of funds. As a result of this exercise, it was found that the ratios stand at 130.7% at Sonali Bank, 109.9% at Janata Bank, 73.9% at Agrani Bank and 73.4% at Rupali Bank. The ratios achieved by Janata and Sonali Banks are considered to be comfortable, whereas those of Agrani Bank and Rupali Bank are found to have the long term liabilities in excess of what is required for healthy management. The fact suggests the inability at the two institutions for performing the basic function of the financial intermediation due to the environment and constraints that they had confronted.

10) Overall Performance

Summing up the above, the performance of Janata Bank shows a satisfactory result in all of the areas covered above, i.e. minimum capital, loans to deposits ratio, capital adequacy ratio, ROA, ROE, NPL and maturity matching. Sonali Bank is acknowledged to have achieved a stabilized capital adequacy ratio and loans to deposits ratio, while continued efforts are required to reduce NPLs and improve its earnings power. Agrani Bank's attainment of the capital adequacy ratio in meeting the regulatory requirements is another point to be commended while the bank needs to continue its efforts to reduce NPLs and improve its earning power. Rupali Bank is found to be a step behind the other three SCBs in the reforming process, and its major milestone is deemed as the eradication of accumulated losses. The bank as well as the government is urged to expedite the important milestone and put the bank on the reforming track for a speedy catching up with the other three SCBs.

4.5 Regulatory Control and Supervision of Financial Institutions

4.5.1 Preventive Measures and Safety Net

The financial system confronts with various risks. Measures have to be established and prepared for securing the stabilized and smooth functioning of the system as a whole through the risks and volatile environment. It is imperative for the financial system to maintain a sound competitive condition through which the financial system can foster the self-regulating mechanism of the market based on the check and balance system. The regulatory control needs to be adequately developed and enforced so that the management of the financial institutions is properly guided to the prudent management practice. Those measures to be established with the aims at preventing the failure of financial institutions are categorized as the preventive measures which include but not limited to; promotion and maintenance of competitive environment, control of financial ratios, examination and supervision of banks. On the other hand, measures are also required for coping with the failure of financial institutions and dissolution. Those measures are defined as the safety net system which includes but not limited to; the lender of last resort lending by BB, deposit insurance, and bailing-out of the troubled bank by the government. The preventive measures are exerted primarily by BB through the enforcement of the regulatory control, the significant ones of which are reviewed as below.

4.5.2 Prudential Regulations

In order to build up a sound financial system, to modernize the banking sector, and to strengthen the balance sheets by ensuring the capital base after adequate provision for risky assets, BB issued a number of prudential guidelines regarding the banks' capital base, reserve ratios, SME financing, corporate governance, legal issues, and charges and fees. The essential part of the regulatory guidelines was compiled by BB in a handbook titled as "Prudential Regulations for Banks: Selected Issues". The material covers a wide range of regulatory control including the following items[47]:

i) Policy on capital adequacy,
ii) Policy on loan classification,
iii) Corporate governance in bank management,
iv) Restrictions on lending to directors at private banks,
v) Appointment of Chief Executive and Advisors in banks,
vi) Constitution of the board and fit and proper tests for appointment,
vii) Constitution of audit committees of the board,
viii) Single borrower exposure,

[47] BB, "Prudential Regulations for Banks: Selected Issues", June 2009

ix) Policy on rescheduling of loans,
x) Policy on loan write-off,
xi) Large loan restructuring schemes,
xii) Requirement for information on large loans from Credit Information Bureau,
xiii) Payment of dividends,
xiv) Loan against shares, etc.,
xv) Interest rates on deposits and lending,
xvi) Bank deposit insurance schemes,
xvii) Guidelines on managing core risks,
xviii) Credit rating,
xix) Prudential guidelines for consumer financing and small enterprise financing,
xx) Guidelines for information & communication technology,
xxi) Implementation of credit risk grading manuals.

The following describes specifics of the regulations that are deemed most essential to the financing to SMEs:

(1) Minimum Capital
The Article 13 of the Banking Company Act, 1991 requires all banks to maintain the minimum capital of Taka 4 billion, of which the paid up capital shall be maintained at a minimum Taka 2 billion. Banks having capital shortfall have to meet the shortfall by August 11, 2011[48].

(2) Risk Based Capital Adequacy Ratio
Banks are required to maintain a minimum capital to risk weighted assets ratio at 10% of which core capital is not to be less than 5% effective from December 31, 2007. The guidelines was temporarily modified in March 2010 to the effect that all the banks shall maintain a Capital Adequacy Ratio not lower than: i) 8.0% for the period between January 1, 2010 through June 30, 2010; ii) 9.0% for the period between July 1, 2010 through June 30, 2011; iii) 10.0% for the period beyond July 1, 2011.

BOX 4-2

Basel II

Basel II is recommendatory framework for banking supervision, issued by the Basel Committee of Banking Supervision in June 2004. The objective of Basel II is to bring about international convergence of capital measurement and standards in the banking system. The Basel Committee members who finalized the provisions are primarily representatives from the G10 countries, but several countries that are not represented on the committee have also stated their intent to adopt this framework.

BB, in December 2008, has issued guidelines on the New Capital Adequacy Framework (BRPD Circular 09, dated 31.12.08) to banks operating in Bangladesh, based on the Basel II framework. These guidelines inform that BB suggests implementation of Basel II with the following approaches:

i) standardized approach for calculating RWA against credit risk,
ii) standardized approach for calculating RWA against market risk; and
iii) basic indicator approach for calculating RWA against operational risk.

Under the standardized approach for measuring credit risks, the risk grades are determined on the basis of ratings assigned by External Credit Assessment Institutions.

48 Previous regulation for minimum capital was for the amount of Tk 2.0 billion in the paid-up capital plus statutory reserve. Banks with shortfalls had to meet at least 50% of the shortfall by June 2008 and the rest by June 2009.

Risk Weights of Corporate Claims under Basel II

CLAIMS ON CORPORATE (excluding equity exposures)	Bangladesh Bank Rating Grade	Equivalent CRAB Rating	Risk Weight %
	1	AAA	20
	2	AA1, AA2	50
	3,4	AA3, A1, A2, A3, BBB1, BBB2, BBB3	100
	5,6	BB1, BB2, BB3, B1, B2, B3, CCC1, CCC2, CCC3, CC, C, D	150
	Unrated	-	125

Source: BB, "Annual Report 2008-09"

(3) Asset Classification and Provisioning

Under the regulations, all loans and advances are grouped into four categories for the purpose of classification, namely: i) continuous loan, ii) demand loan, iii) fixed term loan, and iv) short term agricultural and micro credit. Banks are mandated to classify the loans and advances depending upon the length of arrear, the period during which the loans and advances remain unpaid while passing through the due dates for principal or interest payments. The following table summarizes the determinant and required provisions for each group of loans and advances under the classification rule:

Table 4-9: Asset Classification and Provisioning

Classification	Demand Loan	Term Loan up to 5 years	Term Loan over 5 years	Short Term Agricultural	Provisioning *1
Standard	Loans other than specified below				i) 1% of all unclassified loans ii) 5% on the unclassified amount for Consumer Financing iii) 1% for off-balance sheet exposures
Special Mention	Arrears exceeding 3 months	Arrears exceeding 3 months	Arrears exceeding 3 months		5% on the outstanding amount of loan
Unsatisfactory	Arrears exceeding 4 months	Arrears exceeding 4 months	Arrears exceeding 6 months		i) 5% for Agricultural ii) 10% for others
Sub-Standard	Arrears exceeding 6 months	Arrears exceeding 6 months	Arrears exceeding 12 months	Arrears exceeding 12 months	i) 5% for Agricultural ii) 20% for others
Doubtful	Arrears exceeding 9 months	Arrears exceeding 12 months	Arrears exceeding 18 months	Arrears exceeding 36 months	i) 5% for Agricultural ii) 50% for others
Loss	Arrears exceeding 12 months	Arrears exceeding 18 months	Arrears exceeding 24 months	Arrears exceeding 60 months	100% for all groups

Source: BB, "Prudential Regulations for Banks: Selected Issues", June 2009 and "Prudential Regulations for Small Enterprises Financing", 2004

Note: *1: The provision is to be made at the above rate on the balance calculated by deducting the amount of 'Interest Suspense' and the value of eligible securities from the outstanding balance of classified accounts.

The period of arrears adopted as the determinant for classification needs to be carefully looked at. The period allowed before the loans classified are found to be significantly long in comparison with the prevailing international practices. Besides, term loans of longer maturity are granted with allowances even longer than for demand loans in a practice which is internationally unusual. Agricultural credit is treated with an extremely long period before classification. What is more serious is that borrowers can be rescheduled as performing loans if they pay a set fee for 10% of the outstanding debt for the first rescheduling[49]. Internationally, rescheduling itself constitutes a pre-condition for a loan to be classified if such an action takes place beyond commercial principles. The regulations of BB are to be doubted on this account. BB waived the payment of the fee up to September 30, 2009 for rescheduling of loans to priority sectors in export oriented industries, especially frozen food, the leather industries and leather products, jute and jute goods, textiles and the RMG industry[50] The long gestation period for classification implies that a significant amount of loans are accumulated in the warning zone just outside the classification area. When reading the NPL statistics of the country, it is necessary to discount this due to those factors.

(4) Single Borrower Exposure

BB regulated the scheduled banks to fix limits on their large credit exposures and their exposures to single and group borrowers. The limits have been set at 35% of the capital held by banks in accordance with Section 13 of the Banking Company Act of 1991 since 2005[51]. The total outstanding facilities shall not exceed 35% of capital subject to the condition that the maximum funded outstanding does not exceed 15% of the bank's total capital. For the export sector, however, single borrower exposure remains at 50% of the bank's total capital.

(5) Interest Rates on Deposit and Lending

Banks are, in principle, free to fix their rates of interest on deposits as the previous regulation setting the floor rate[52] has been revoked. Banks used to be given freedom in fixing their rates of interest on lending except for the export sector, which was fixed at 7% p.a. with effect from January 10, 2004. Under this regime of free interest rates, banks are required to publicly announce the mid-rate of the limit to different sectors, and were allowed to change interest by 1.5% more or less than the announced mid-rate. In April 2009, however, BB introduced a new regulation setting a ceiling on the interest rate on loans to agriculture, term and working capital loans to large and medium scale industries, housing loans, and trade financing at 13% p.a. against the backdrop of the prevailing inflation and global economic conditions[53]. The overall effect of the ceiling rate is observed as follows:

Table 4-10: Composition of Loan Portfolio by Interest Rate

%, Taka billion

Rate of Interest	Dec 2008		Mar 2009		Jun 2009		Sep 2009	
	Loan Balance	%	Loan Balance	%	Loan Balance	%	Loan Balance	%
0% - 5.0%	228.6	11.6%	238.9	11.8%	260.2	12.4%	279.8	12.9%
5.1% - 10.0%	188.6	9.6%	187.4	9.3%	189.2	9.1%	194.8	9.0%
10.1% - 13.0%	317.5	16.2%	315.5	15.6%	825.7	39.5%	1,080.8	49.9%
13.1% - 20.0%	1,212.3	61.7%	1,264.2	62.5%	800.4	38.3%	592.3	27.4%

49 BB, "Prudential Regulations for Banks: Selected Issues", June 2009

50 BB, "Annual Report 2008-09"

51 BB, "BRPD Circular No. 5 dated April 9, 2005"

52 BB, "BRPD Circular No. 1 dated February 19, 1997"

53 BB, "Annual Report 2008-09"

Rate of Interest	Dec 2008		Mar 2009		Jun 2009		Sep 2009	
	Loan Balance	%	Loan Balance	%	Loan Balance	%	Loan Balance	%
20.1% - 30.0%	16.8	0.9%	62.5	0.8%	15.2	0.7%	16.4	0.8%
Total	1,963.9	100%	2,022.4	100%	2,090.5	100%	2,164.4	100%

Source: BB, "Scheduled Banks Statistics" Quarterly: Jan-Mar 2009, Apr-Jun 2009 and Jul-Sep 2009.

The above table indicates that prior to the imposition of the ceiling rate, 63.3% of the total loan portfolio of the scheduled banks were occupied by the loans with interest rates higher than 13.0% which were comprised of 62.5% at the interest rates between 13.1%-20.0% and 0.8% at the interest rates between 20.1%-30.0% in March 2009. On the other hand, 36.7% of the total portfolio was the loans with interest rates lower than 13.0%. After the imposition of the ceiling rate, the share of the loans with interest rates exceeding 13.0% declined drastically to 39.0% in June 2009 and to 28.2% in September 2009. In contrast, the share of the portfolio whose interest rates were not exceeding 13.0% jumped to 61.0% in June 2009 and to 71.8% in September 2009.

More precisely, out of the above table of the total loan balance for the scheduled banks, the following table focuses on the changes of loan balances that took place prior to and after the imposition of the ceiling rate at the loans with specific interest rates between 12.1% and 16.0%:

Table 4-11: Changes of Loan Balance at the Focused Interest Rates

Taka billion

Interest Rate	Loan Balance at March 2009	Loan Balance at June 2009	Change from Mar. 2009
12.1%-13.0%	157.9	665.3	+507.4
13.1%-14.0%	404.7	203.0	-201.7
14.1%-15.0%	528.5	330.6	-197.9
15.1%-16.0%	233.0	177.6	-55.4
Sub-Total for 13.1%-16.0%	1,166.2	711.2	-455.0

Source: BB, "Scheduled Banks Statistics" Quarterly: Jan-Mar 2009, Apr-Jun 2009 and Jul-Sep 2009

The above table shows that prior to the introduction of the ceiling rate the loan balance whose interest rates were at 13.1%-16.0% amounted for Tk 1,166.2 and overwhelmed the loans of interest at 12.1%-13.0% which stood at Tk 157.9 billion. Upon the imposition of the ceiling rate, the loans of interest at 13.1%-16.0% decreased by Tk 455.0 billion (39.0% of the pre-ceiling balance) whereas the loans of 12.1%-13.0% increased by Tk 507.4 billion (321% of the pre-ceiling balance) resulting in the situation that an almost same amount moved from the higher interest rates to the lower rates. It can be largely construed that the scheduled banks coped with the ceiling regulation by way of decreasing the interest rates that had been provided at 12.1%-16.0% to 12.1%-13.0%.

The imposition of the ceiling rate at 13% p.a. has apparently led financial institutions to reduce their lending volume whose interest rates are exceeding 13% p.a. In spite of such, financial institutions managed to increase the total loan portfolio. Unfortunately, it is not known the impact of ceiling rate upon the lending activities for SMEs, in particular, in respect of the volume of loans granted. It is presumed that financial institutions coped with by reducing the interest spread, which is yet to be studied, resulting in the ultimate reduction of the lending interest rates.

Incidentally, IMF commented on the introduction of the new ceiling for the interest rate on lending to the effect that non-prudential interventions such as ceilings on lending rates for priority sectors, moral suasion, direct lending and easing debt service for some sectors are counterproductive in the long run. IMF expresses its understanding of the imposition of the ceiling rate by BB on the condition that they are temporary in nature. It stresses that they should be removed as soon as possible and in any case before market interest rates rise with higher inflation[54].

(6) Guidelines for Small Enterprise Financing

The prudential guidelines stated above contain in their components the establishment of the prudential guidelines for small enterprise financing. BB issued basic principles for the guidelines that are to be established at each financial institution by releasing material titled "Prudential Regulations for Small Enterprises Financing" in 2004. Under these principles, financial institutions entering into the SME financing business are required to establish their own guidelines for SME lending. The principle not only prescribes the prudential limits to which banks must comply, but also the organizational developments to be made within the banking institutions from the pre-operation phase, through operation, and regarding disclosure/ethics. The material contains components which include the followings:

i) Prudential Regulations
   - ✓ Repayment capacity and cash flow backed lending
   - ✓ Personal guarantee
   - ✓ Per party exposure limit
   - ✓ Aggregate exposure of bank/NBFI on SMEs
   - ✓ Limit on clean facilities
   - ✓ Securities
   - ✓ Loan documentation
   - ✓ Margin requirement
   - ✓ Credit Information Bureau clearance
   - ✓ Minimum condition for taking exposure
   - ✓ Proper utilization of loan
   - ✓ Restriction on facilities to related parties
   - ✓ Classification and provisioning for assets

ii) Development Guidelines
   - ✓ Policy guidelines
   - ✓ Procedural guidelines
   - ✓ Credit administration
   - ✓ Risk management
   - ✓ Collection and remedial management

iii) Preferred organization chart and responsibilities

The following describes the specifics of the regulations that are of particular importance:

1) Aggregate Exposure

BB establishes specific ceiling amounts of aggregate to be provided to small enterprises which are applicable to each individual financial institution and that are to be fixed based on the actual classification of the bank's portfolio for small enterprise. Those financial institutions with lower

[54] IMF, "Bangladesh-Staff Report for the 2009 Article IV Consultation", December 2009

classified ratio are allowed higher ceilings for small enterprise lending. The aggregate exposure of a bank in the small enterprise sector is regulated by BB not to exceed the limits specified below:

Table 4-12: Maximum Limit of Small Enterprise Financing

% of Classified Small Enterprise Advances to Total Portfolio of Small Enterprise Advances	Maximum Limit
1) Below 5%	10 times of equity
2) Below 10%	6 times of equity
3) Below 15%	4 times of equity
4) At and above 15%	Up to the equity

Source: BB, "Prudential Regulations for Small Enterprise Financing", 2004

2) Securities

Banks are free to determine security requirements for loans up to Tk 0.5 million. For loans exceeding this limit the banks must, as a minimum requirement, take charge over the assets being financed and in addition, these loans shall be secured by the banks as follows:

- i) hypothecation on the inventory, receivables, advance payments, plants and machineries,
- ii) equitable mortgage over immovable properties with registered power of attorney,
- iii) personal guarantee of spouse/parents/other family members,
- iv) one third-party personal guarantee
- v) post-dated cheques for each installment and one undated cheque for full loan value including full interest.

The specific norms given by BB, however, are rather rigid and severe and cannot be assessed as conducive to easier borrowing for small enterprises. The aggregate amount allowed for small enterprises financing established by BB for financial institutions could be of a future constraints for some of the banks pioneering the small enterprise market. With respect to the securities issue, the guidelines instruct the banks to obtain securities for loans exceeding Tk 0.5 million, which is equivalent to an approximate amount of USD 7,200. The listing of the documents to be obtained from borrowers is another example of the cumbersome procedures. The small enterprise market is recognized as being a dynamic market and requires flexibility. Banks should be granted with the freedom to carry on their financing operation within the broader regulatory guidelines for healthier business and management. There is a need for the government and BB to further improve the above prudential guidelines so that small enterprises can have access to financial services with easier terms and conditions.

4.5.3 Supervision of Banks

According to the Annual Report of BB, the system and practice of banking supervision functions as follows[55]:

> With a view to promoting and maintaining soundness, solvency and systemic stability of the financial sector as well as protection of depositors' interest, BB carries out two types of supervision, namely: i) off-site supervision, and ii) on-site supervision. The Departments concerned monitor and evaluate the performance of the banking sector through CAMELS rating which involves analysis and evaluation of the six crucial dimensions of banking operations: i) capital adequacy, ii) asset quality, iii) management soundness, iv) earnings, v) liquidity, and vi) sensitivity to market risk. Based on their performance, banks are rated in

[55] BB, "Annual Report 2008-09"

one to five grades in ascending order. Any bank rated four or five is classified as 'Marginal' or 'Unsatisfactory' and is generally identified as a Problem Bank[56]. At present, there are two banks classified as Problem Banks placed under careful monitoring for improvement. After March 2005, on the other hand, BB introduced an Early Warning System (EWS) of supervision to address the difficulties faced by the banks in any of the CAMELS areas. Any bank found to have faced difficulty in any areas of operation, is brought under EWS category and monitored closely to help improve its performance. Presently, seven banks are monitored under EWS[57].

4.5.4 Financial Infrastructure

The healthy development of the financial system requires the simultaneous integrated development among the legal and regulatory enactment, the financial infrastructure and supply of funds. In addition, the stabilization of the financial system requires the adequately developed safety net for orderly functioning through a volatile environment. Aside from the legal and regulatory enactment, the financial infrastructure embraces a broad scope of objects including but not limited to; accounting and auditing, bank supervision, information infrastructure, clearing and settlement, safety net facilities, etc. While the legal and regulatory issues are dealt earlier in previous subsections, the present status of the other important infrastructure which is closely related to SME lending is reviewed hereunder:

(1) Credit Rating

The banks have been made mandatory by BB to have themselves credit rated by a credit rating agency with a view to safeguard the interest of prospective investors, depositors and creditors and also the bank management as a whole for their overall performance in each relevant areas including the core risks of the banks[58]. Banks are obliged to disclose their credit rating in their published annual reports and half yearly financial statements. In April 2009, BB accredited Credit Rating Agency of Bangladesh Ltd., as an External Credit Assessment Institution (ECAI). Under the standardized approach for calculating risk weighted assets against credit risk, the credit rating is to be determined on the basis of risk profile assessed by the ECAIs. Banks will use the ratings of the ECAIs and corresponding risk weight for calculating RWA for credit risk under the standardized approach.

(2) Credit Information System

The Credit Information Bureau (CIB) was established with the assistance of the World Bank and has been in operation since 1992 with the main objective of minimizing the extent of default loan by facilitating the banks and financial institutions with credit reports of the loan applicant so that the lending institutions do not encounter avoidable credit risks[59]. The system operates in such manner that financial institutions are mandated to supply details of individual borrowers, owners and guarantors to CIB on hard copies to be stored at the database. Financial institutions are also obligated to take the credit information from CIB when making an appraisal of the credit application submitted on hard copy basis. The number of reporting and withdrawal of credit information has been expanding rapidly. It is pointed out by IMF that CIB suffers from several shortcomings including lengthy and manual operations[60]. With the assistance of DFID, CIB is in the process of automating the system by applying the latest information technology. The on-line connection between CIB and its participant banks is scheduled to be completed in

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[56] ditto

[57] ditto

[58] Bangladesh Bank, "BRPD Circular No. 6, dated July 5, 2006 (Bangladesh Bank, "Prudential Regulations for Banks: Selected Issues, June 2009)

[59] The rules and regulations for the operation of CIB has been notified by CIB Circular No. 02 dated December 27, 1992. (Bangladesh Bank, "Prudential Regulations for Banks: Selected Issues, June 2009)

[60] IMF, "Bangladesh: Financial System Stability Assessment", February 2010

2010.

(3) Deposit Insurance System

The deposit insurance scheme has been established and operated based on the Bank Deposit Insurance Act 2000. The rules and regulations have been notified by BRPD Circular No. 10 dated September 7, 2000. Under the law, deposits of all scheduled banks are insured up to Tk 100,000 per depositor. Each insured bank is to pay the premium for 0.07% p.a. on the insured portion of its deposits[61]. NBFIs are yet to be admitted to participate in the Deposit Insurance System.

4.5.5 Performance and Financial Soundness of Individual Institutions

There exist no comprehensive reports which list and analyze the performance of the financial institutions. The JICA Survey Team has collected financial information disclosed by the financial institutions using various means including annual reports, or statements publicly released through web-sites for analytical processing. Results are attached as Annex 4. The amounts of financial information collected so far are; 4 out of 4 from SCBs, 3 out of 4 SBs, 27 out of 30 PCBs, 2 out of 9 FCBs, and 13 out of 29 NBFIs[62]. The information collected presently includes that of 2008 which should be replaced with the later information when it becomes available. The following is the overall findings including those of NBFIs through their analysis:

(1) Minimum Capital Requirement

As stated before, all banks must maintain minimum capital for Taka 4.0 billion, out of which paid up capital shall be maintained at minimum Taka 2.0 billion. Banks having capital shortfall have to meet the shortfall by August 11, 2011[63]. NBFIs, on the other hand, are to maintain minimum paid-up capital at Tk 500 million. Any of the institutions failing to meet the minimum have to fulfill the deficiency by December 31, 2010[64]. A large number of financial institutions are yet to fulfill the requirement.

(2) Capital Adequacy Ratio

Commercial banks are to have a minimum 10% of capital adequacy, 5% of which must be TIER 1 capital. NBFIs are not subject to the capital adequacy ratio. BB introduced a temporary relaxing of the ratio for the period up to June 30, 2011 as a step for financial institutions to move to the BASEL II regulatory regime smoothly. The overall performances of the financial institutions in CAR are reviewed and disclosed by BB as follows[65]:

Table 4-13: Capital Adequacy Ratio by Types of Banks

%, as of end of each year

Calendar Year	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	4.4	4.3	4.1	4.3	4.1	-0.4	1.1	7.9	6.9
SBs	3.2	3.9	6.9	7.7	9.1	-7.5	-6.7	-5.5	-5.3
PCBs	10.9	9.9	9.7	10.5	10.3	9.1	9.8	10.6	11.4

61 Bangladesh Bank, “Prudential Regulations for Banks: Selected Issues, June 2009

62 The financial information collected are either in the hard copy or by downloading from the website. Financial information collected only for 2009 or in its absence for 2008. The information dated prior to 2008 was disregarded. The information downloaded from the website are deemed obtained so long as the information contained as a minimum; balance sheet, income statement and notes to financial statement.

63 BB, “Prudential Regulations for Banks: Selected Issues”, June 2009. Previous regulation for minimum capital was for the amount of Tk 2.0 billion in the paid-up capital plus statutory reserve. Banks with shortfalls had to meet at least 50% of the shortfall by June 2008 and the rest by June 2009.

64 BB, “DFIM Circular No. 09 dated November 4, 2009/20 Falgun, 1416”

65 BB, “Annual Report 2008-09”

Calendar Year	2000	2001	2002	2003	2004	2005	2006	2007	2008
FCBs	18.4	16.8	21.4	22.9	24.2	26.0	22.7	22.7	24.0
Total	6.7	6.7	7.5	8.4	8.7	5.6	6.7	9.6	10.1

Source: BB, "Annual Report 2008-09"

It should be noted that some of the banks among SCBs, SBs and PCBs including those which are problem banks, are falling short of making sufficient provisions. BB reports that as of FY 2008, the provision maintenance ratio which compares the actual provision maintained against the provision required stood at 92.7%[66]. The CARs described above theoretically have to be discounted for the shortfall of provisions. The CARs of SCBs were consistently below the regulatory minimum during the nine years reviewed. SBs' performance was even worse. PCBs are acknowledged to have barely been clearing the CAR requirement during most recent years. FCBs maintain high levels of CARs that clear the regulatory guidelines. The summary of analysis on the individual financial institutions will be tabulated in the final end of this subsection.

(3) Earnings Ratio

Earnings of the financial institutions are tested on such indicators as the return on assets, the return on equity, the cost of funds, the operating costs, the net interest margin, etc. In addition, the efficiency of the financial institution is tested by scrutinizing such statistics per employee of the average loan balance and net profit. No substantive outcome has been obtained so far for the cost and margin items due to the limited disclosure made by banks. The following table summarizes the ROA, ROE and efficiency figures for the groups of financial institutions:

Table 4-14: ROA and ROE by Types of Banks

	ROA (%)	ROE (%)	Ave Loan Balance per Employee (Tk thousand)	Ave Profit per Employee (Tk thousand)
SCBs	0.78	9.86	5,846	123
SBs	-0.18	n.a.	37,102	748
PCBs	1.50	22.17	38,321	863
FCBs	3.29	n.a.	n.a.	n.a.
NBFIs	3.48	28.69	74,024	3,801

Source: Financial Institutions, "Annual Reports"

Note: *1: The statistics covers only the institutions whose information have been made available and does not represent the total member institutions.

*2: The figures indicated above are simple average among the banking group but not of weighted average.

It should be noted that SCBs are trailing behind the other groups with respect to the profitability and efficiency of their operations. It can be safely said that the SCBs are approximately one half of PCBs in terms of profitability indicators of ROA and ROE and one seventh in terms of efficiency indicators of loan balance and profits per employee. It should not be forgotten that there exist three banks, two from SBs and one from PCBs that are running a negative net profit after tax in the latest financial closing (which was 2008). These banks are the ones included among the negative net worth banks cited above.

[66] BB, "Annual Report 2008-09"

(4) Medium/Long Term Lending

Unfortunately, there are no official statistics compiled for medium/long term lending. The analysis has attempted to obtain figures for the medium/long term lending and deposit from the information collected. BB defines the term loan as the loan whose maturity exceeds one year. To make the terms clear, this study defines the medium/long term lending and deposits as the ones whose residual maturity exceeds one year. The following table summarizes the medium/long term lending and deposit ratios for each type of institutions:

Table 4-15: Medium/Long Term Lending and Deposits by Types of Banks

	Loans and Advances of Residual Maturity Exceeding One Year (Tk billion)	Ratio of M/L Term Lending against the Total Loans and Advances (%)	Deposits of Residual Maturity Exceeding One Year (Tk billion)	Ratio of M/L Term Deposits against the Total Deposits (%)
SCBs	266.6	44.8%	499.8	56.2%
SBs	7.2	26.4%	5.7	14.9%
PCBs	491.1	37.5%	439.0	28.3%
FCBs	16.6	29.3%	18.3	18.1%
NBFIs	15.5	50.9%	7.9	29.2%

Source: Financial Institutions, “Annual Reports”

Note: The aggregated sum is for the banks whose information made available and does not represent the total member institutions for each group.

The above indicates that SCBs as well as FCBs have medium/long term deposits exceeding their portfolio of medium/long term lending. SBs and PCBs have shortfalls in raising the medium/long term deposits to cover their medium/long term lending. Individual institutions are found to vary in their rates of medium/long term lending and deposits. Banks may find it comfortable, should the levels of medium/long term lending and that of deposits stand closer while banks need to be prudent so as to avoid taking excessive risk of maturity mismatches. Corrective action needs to be taken when the medium/long term loan ratio exceeds that of deposit by a wide gap. The summary of analysis on the individual financial institutions will be tabulated in the final end of this subsection.

(5) Maturity Matching

Banks are required to disclose liquidity positions by presenting a liquidity table enumerating major categories of assets and liabilities broken down into periods of: less than one month, one to three months, three to twelve months, one to five years and above five years. In an attempt to scrutinize the position of financial institutions in respect of the sufficiency of fund raising that are matching in maturity, an analysis was conducted in using the maturity mismatch ratio that is defined by the JICA Survey Team as the total assets whose maturity exceeds one year excluding properties, fixtures and furniture denominated by the total liabilities of comparable maturity.

Based on the financial data collected from banks and NBFIs, the JICA Survey Team found out that there had been some maturity mismatches particularly conspicuous among PCBs. Approximately 50% (14 out of 27 banks) of PCBs surveyed faced maturity mismatches including the minor mismatches. The total amount of medium-and long-term loans over deposits of residual maturities exceeding one year reaches about Tk 122 billion. It is considered that the limited availability of longer-term funds has posed difficulties to banks and NBFIs in constraining extension of medium-and long-term loans to the business sector.

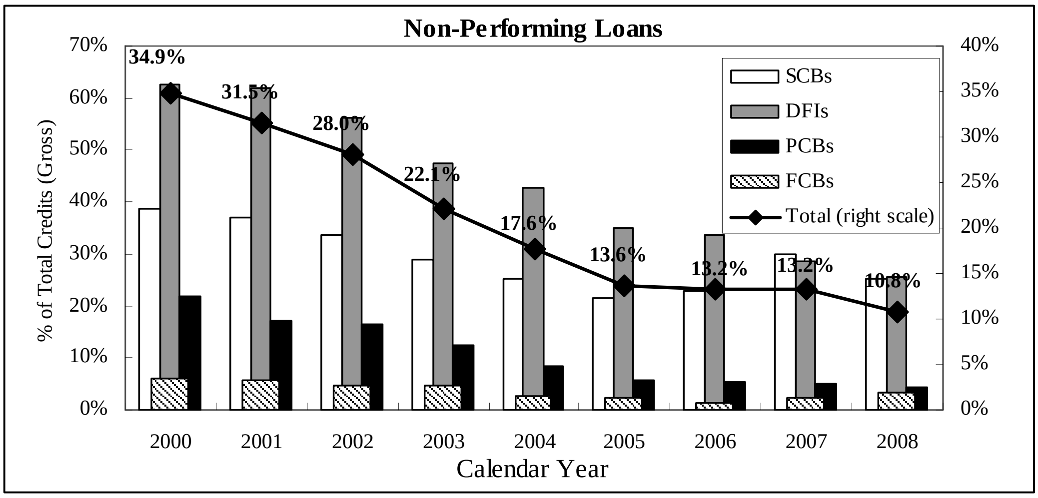
Table 4-16: Extent of maturity mismatch

Type	Total number of institutions	Total number of institutions where financial documents (FY 2008 or 2009) have been collected	Loans and Advances of Residual Maturity Exceeding One Year (Tk billion)	Deposits of Residual Maturity Exceeding One Year (Tk billion)	Sum of absolute values of amounts of loans and advances over deposits of residual maturity exceeding one year (Tk billion)	Total number of institutions where maturity mismatch has been observed
SCBs	4	4	266.6	499.8	0.0	0
SBs	4	3	7.2	5.7	1.5	1
PCBs	30	27	491.1	439.0	108.7	14
FCBs	9	2	16.6	18.3	0.9	1
NBFIs	29	13	15.5	7.9	10.5	5
Total	76	49	797.0	970.7	121.6	21

Source: JICA Survey Team based on annual reports from financial institutions
Note 1: Financial documents referred are either FY 2008 or FY 2009.
Note 2: Although financial documents have been obtained, not all financial institutions provide detailed information on maturity structure.

While the above data is for the average of the group of financial institutions, there exist substantial variances among the individual institutions. No case of serious concern is found among SCBs, SBs and FCBs. The cases for attention are found at the banks whose maturity matching ratio exceeds 200%. The banks found in such category are; 7 from PCBs, i.e. The City Bank (323.1%), Eastern Bank (302.7%), South East Bank (212.4%), Dhaka Bank (298.4%), First Security Bank (240.1%), Trust Bank (348.0%), and Mutual Trust Bank (344.1%); 1 from NBFIs, i.e. Phoenix Finance (203.5%).

(6) Non-Performing Loans
Non-performing loans are often discussed in many occasions in Bangladesh. The overall performance of the financial sector by types of financial institutions is being reviewed and reported on by BB as follows[67]:



Source: BB, "Annual Report 2008-09"

Figure 4-11: Non-Performing Loans

67 BB, "Annual Report 2008-09"

The gross NPLs in the total banking sector stood at 10.8% in December 2008. The underlying data for this performance is reported to be as follows:

Table 4-17: Non-Performing Loans (Gross) by Types of Banks

%, as of end of each year

Calendar Year	2000	2001	2002	2003	2004	2005	2006	2007	2008
SCBs	38.6	37.0	33.7	29.0	25.3	21.4	22.9	29.9	25.4
SBs	62.6	61.8	56.1	47.4	42.9	34.9	33.7	28.6	25.5
PCBs	22.0	17.0	16.4	12.4	8.5	5.6	5.5	5.0	4.4
FCBs	3.4	3.3	2.6	2.7	1.5	1.3	0.8	1.4	1.9
Total	34.9	31.5	28.0	22.1	17.6	13.6	13.2	13.2	10.8

Source: BB, "Annual Report 2008-09"

In terms of average performance, FCBs have the lowest and SBs have the highest ratios of gross NPLs to total loans. SCBs have a gross NPL ratio of 25.4% whereas for SBs, PCBs and FCBs, the ratios are 25.5%, 4.4% and 1.9% respectively. The performance of FCBs is in line with the internationally prevailing levels and that of PCBs is at an acceptable level. The levels of NPLs recorded at SCBs and SBs, although having improved from previous years, are dangerously high and further action for reduction needs to be vigorously taken. The gross NPL ratio of all the banks shows a significant improvement at 10.8% in 2008 from 34.9% in 2000, although the aggregate ratio is still high considering the prevailing levels of the average spread of interest and average ROA. It should be taken into account that the criteria for asset classification are relatively long and that there are a number of loopholes that may provide shelters for arrear loans from being counted as NPLs. The actual position may be somewhat more serious than that are shown in the statistical disclosure.

(7) Weaknesses of Individual Institutions

The review conducted on the actual performance of the financial institutions is summarized hereunder by listing up the major deviations and weaknesses found from the regulatory norms and other points that are conceived as the weaknesses of the individual financial institutions for being actively engaged in SME financing, particularly in medium/long term lending:

Table 4-18: Weaknesses of the Financial Institutions

Regulatory Item	Norm	Deviations
Minimum Capital	Tk 4 billion in net worth out of which Tk 2 billion in paid-up capital (*1) (Tk 0.5 billion in net worth for NBFIs). Deadline for compliance: August 2011 (NBFIS: December 2010)	A large number of institutions having shortfalls including; 1 SCBs, 3 SBs, 15 PCBs, and 3 NBFIs.
Capital Adequacy	10% for the years prior to Jan. 1, 2010 with a temporary relaxation till July 2011 for transition to BASEL-II.	Financial institutions of negative net worth are found at; Rupali Bank (SCB), Bangladesh Krishi Bank (SB), RAKUB Bank (SB), and ICB Islamic Bank (PCB).
Non-Performing Loans	No regulatory norm is established but affects the CAMELS rating by BB	Financial institutions whose NPLs exceeding 10% are found at; Sonali Bank (SCB), Agrani Bank (SCB), Rupali Bank (SCB), Bangladesh Krishi Bank (SB), RAKUB Bank (SB), ICB Islamic Bank (PCB), IPDC (NBFI), and Fareast Finance (NBFI).

Regulatory Item	Norm	Deviations
Earning Capability	No regulation	Banks recording negative net profits are found at; Bangladesh Krishi Bank (SB), RAKUB Bank (SB), ICB Islamic Bank (PCB)
Medium/Long Term Lending	No regulation	Financial institutions whose medium/long term lending ratio remain less than 20% are at; Dutch-Bangla Bank (PCB), and Citi Bank N.A. (FCB).
Medium/Long Term Deposits	No Regulation	Financial institutions whose deposits are comprised of medium/long term at less than 20% are at; Basic Bank (SB), The City Bank (PCB), Eastern Bank (PCB), South East Bank (PCB), Dhaka Bank (PCB), Dutch-Bangladesh Bank (PCB), EXIM Bank (PCB), Premier Bank (PCB), First Security Bank (PCB), Trust Bank (PCB), Mutual Trust Bank (PCB), and Citi Bank N.A. (FCB).
Gaps between Ratios of Medium/Long Term Deposits and of Medium/Long Term Lending	No Regulation	Financial institutions having the gap exceeding 20% are at; The City Bank (PCB), Eastern Bank (PCB), Dhaka Bank (PCB), First Security Bank (PCB), Trust Bank (PCB), and Mutual Trust Bank (PCB).
Maturity Matching	No Regulation	Financial institutions having the maturity matching ratio exceeding 200% are at; The City Bank (PCB), Eastern Bank (PCB), South East Bank (PCB), Dhaka Bank (PCB), First Security Bank (PCB), Trust Bank (PCB), and Mutual Trust Bank (PCB).

Source: Individual Financial Institutions, “Annual Reports” various editions
Note *1: Previous regulation for minimum capital was for the amount of Tk 2.0 billion in the paid-up capital plus statutory reserve. Banks with shortfalls had to meet at least 50% of the shortfall by June 2008 and the rest by June 2009.

4.6 Activities of Financial Sector for SMEs

4.6.1 Overview of Financial Sector for SMEs

This section consists of two parts. The first part overviews the total credits extended by financial institutions. Rapid expansion of credits particularly in the industrial and trade sectors, and the increasing role of PCBs in the financial sector will be noted. The second part will highlight the credit to SMEs. In parallel with the overall pattern, credit to SMEs has also increased. Based on the available statistics at BB, the second part of this section examines sectors that received financial support, the types and size of loans, and discusses possible constraints in extending financial supports to SMEs.

(1) Total Credits by Financial Institutions
Financial institutions are offering a wide variety of loan products to meet their customers’ needs. Typically, bank credit is constituted by advances and bills. Bank advances can be classified into sub-components based on economic purpose. The economic purposes are classified by BB into: agriculture, industry (excluding working capital), working capital financing, construction, transportation, trade and others. In addition, consumer loans are provided to individuals and households. As specialized products, term loans and infrastructure financing are being intensified by financial institutions. Credit is extended through advances, bills purchased and discounted, investments, off-balance sheet finance, etc. The following tables show the outstanding amounts of the total credit and advances by economic sector as of the end of June 2009.

Table 4-19: Total credit and advances of scheduled banks

Tk Million

	Outstanding Balance as of June 2009	%
Total Credit		
Bills purchased and discounted	141,159	6%
Advances	2,090,456	94%
Total	2,231,645	100%
Advances by Economic Sector		
Agriculture, Fishing & Forestry	137,538	7%
Industry (excluding WK financing)	451,261	**22%**
Large & medium scale	401,740	**19%**
Small scale industries	16,991	1%
Cottage industries	1,475	0%
Services industry	31,056	1%
Working Capital Financing	356,685	**17%**
Large & medium scale	339,763	**16%**
Small scale industries	6,997	0%
Cottage industries	396	0%
Services industry	9,530	0%
Construction	143,925	7%
Transport & Communication	35,793	2%
Trade	740,452	**35%**
Wholesale & retail trade	335,476	**16%**
Export financing	102,431	5%
Import financing	265,420	13%
Others	37,125	2%
Others	224,832	11%
Total	2,090,486	100%

Source: BB, "Scheduled Banks Statistics April-June 2009"

The total outstanding credit balance as of end of June 2009 amounted to Tk 2,231.6 billion consisting of Tk 141.1 billion for bills purchased and discounted and Tk 2,090.4 billion for advances. Advances accounted for 94% of the total credit outstanding of scheduled banks as of June 2009. The lower part of the above table shows advances by economic sector. Advances for the industrial sector, other than working capital financing, accounted for 22% as of June 2009. While the share of large and medium scale industries was as big as 19%, that of small scale industries was as small as 1%. The share of the working capital financing was 17% as of the same date. While the share of large-and medium-scale industries was 16%, that of the small scale industries was marginal. Advances to the trade sector show 35% of the total outstanding amount, including 16 % for the wholesale and retail trade.

The following table describes the general trend from FY 2004 to FY 2009 based on the scheduled bank statistics of BB.

Table 4-20: Bank advances (private sector) by economic purposes (Outstanding balance)

Tk billion

Sectors	FY04	FY05	FY06	FY07	FY08	FY09
Agriculture	94.4	104.9	112.1	108.1	121.6	137.5
Industry (other than working capital)	180.6	190.8	235.9	291.0	360.8	451.3
Working capital financing	154.6	192.4	222.9	249.5	306.3	356.7
Construction	62.8	73.3	86.1	104.9	116.6	143.9
Transport and communication	11.2	12.9	18.2	27.8	38.8	35.8
Storage	8.4	7.8	9.2	6.7	5.2	6.3
Trade	309.1	367.8	410.7	467.8	607.2	740.5
Miscellaneous	88.6	98.5	121.9	142.8	194.2	218.6
Total	909.7	1048.4	1217	1,398.9	1750.7	2,090.5
Growth rate for selected sectors of bank advances (outstanding balance)						
Agriculture	9.1%	11.1%	6.9%	-3.6%	12.5%	13.1%
Industry (other than working capital)	15.0%	5.6%	23.6%	23.4%	24.0%	25.1%
Working capital financing	26.3%	24.5%	15.9%	11.9%	22.8%	16.5%
Trade	16.5%	19.0%	11.7%	13.9%	29.8%	22.0%
Total (Nominal)	16.4%	15.2%	16.1%	14.9%	25.2%	19.4%
Total (Real adjusted by CPI)	10.0%	8.2%	8.3%	7.2%	13.9%	12.0%
Growth rate of selected sectors in the GDP at current prices						
Agriculture	6.6%	6.6%	9.7%	11.9%	13.7%	10.4%
Manufacturing sector	12.5%	14.1%	17.2%	17.8%	15.7%	12.8%
Wholesale and retail trade	12.8%	14.0%	13.3%	15.8%	18.5%	12.1%
Total (Nominal)	10.8%	11.3%	12.1%	13.7%	15.5%	12.7%
Total (Constant/Real)	6.3%	6.0%	6.6%	6.4%	6.2%	5.9%

Source: BB, Bangladesh Bank Quarterly April-June, July-September 2009.
Note: The title of this table in BB's Quarterly appears as "Bank Advances (Private Sector) By Economic Purposes," but the amount includes advances to the public sector. According to the scheduled bank statistics, the advances to the public sector as of June 2009 were Tk 84.7 billion and those to the private sector were Tk 2,005.8 billion.

Over the last six years, the outstanding balance of the total bank advances to the economic sector grew at an average annual rate of 18%, particularly in the categories of industry (other than working capital), working capital financing and trade. The growth rate of the advances has far exceeded that of GDP in recent years.

Specifically for industrial loans, BB compiles statistics on both working capital and term loans, from both scheduled banks and NBFIs. The industrial term loan is defined as loans with more than one year repayment period, but the time usually ranges from 2 to 5 years. Industrial term loan does not necessarily mean investment loans, and it is reasonable to assume that industrial term loans are comprised from both working capital and investment loans.

The total balance of industrial loans as of June 2009 was Tk 885.46 billion, out of which about half (Tk 478.08 million) was classified into industrial term loans. The total balance shows an increasing trend over the last three years (11% at the end of FY 2008 to 17% at the end of FY 2009). The share of PCB as of end of 2009 reached over 60%.

The following table focuses on the historical trend of the industrial term loans. As seen from the table, the outstanding term loan more than doubled from FY 2004 to FY 2009. In particular, the portfolio of PCBs rapidly expanded and its share increased to 56% in FY 2009 from 28% in FY 2004.

Table 4-21: Outstanding amounts of industrial term loans

Tk Billion

Fiscal Year	FY2004	FY2005	FY2006	FY2007	FY2008	FY2009
Outstanding amounts of industrial term loans						
SCBs	81.60	78.30	85.40	86.61	81.49	100.11
PCBs	56.50	82.60	115.20	164.73	217.29	268.76
FCBs	8.00	8.80	10.20	13.96	17.62	17.34
SBs	30.50	22.20	21.90	22.69	23.63	24.66
NBFI	27.30	34.40	41.00	49.20	60.90	67.22
Total	203.90	226.30	273.70	337.19	400.93	478.09
Share by type of financial institution						
SCBs	40%	35%	31%	26%	20%	21%
PCBs	28%	37%	42%	49%	54%	56%
FCBs	4%	4%	4%	4%	4%	4%
SBs	15%	10%	8%	7%	6%	5%
NBFI	13%	15%	15%	15%	15%	14%
Total	100%	100%	100%	100%	100%	100%

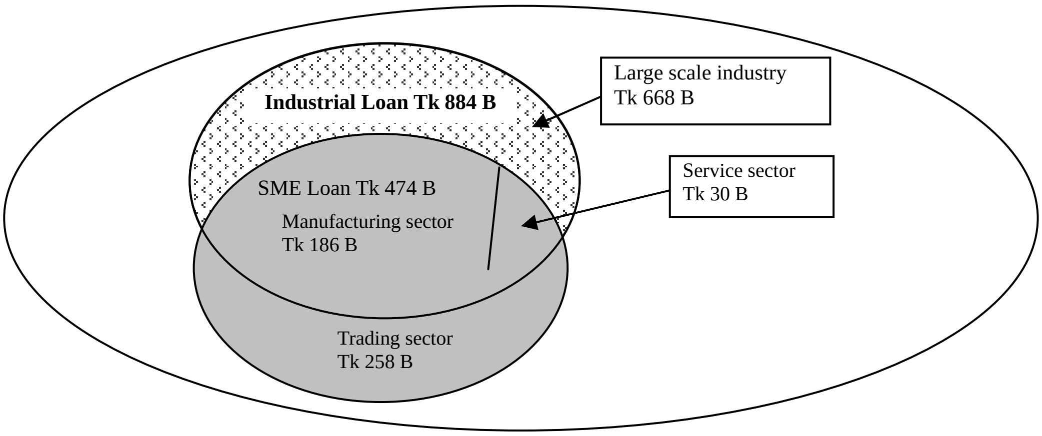
Source: BB quarterly

(2) Credits to SMEs

Use of the available data, the following section highlights credits to SMEs. It can be seen that SME loans account for only 20% of the total outstanding balance of the banks, out of which, the trade sector takes more than half. Over the last three years during which the SME statistics were available, the outstanding balance showed an annual growth rate of 17% to 20%, which was more or less in line with the overall growth of the total outstanding balance. In particularly, PCBs have played an increasingly prominent role. Furthermore, the trade sector accounts for more than half of the SME loans, presumably in the form of short-term loans. The indication is also that loans to SMEs are not comparable to the extent to which SMEs contributed to GDP, implying underinvestment in the SME sector. In addition, it is assumed that a certain range of loan segments has been underserved. From the statistics for industrial loans, it is revealed that only a small fraction of industrial term loans have been extended to SMEs, particularly to small enterprises.

Regarding SME finance, SMESPD of BB prepares statistics on loans to SMEs. As described before, BB also prepares statistics on industrial loans. SME loan statistics shows an outstanding balance of loans in the three economic sectors, but does not distinguish working capital loans from term loans. On the other hand, industrial loan statistics include statistics on the manufacturing and service sectors, but not on the trade sector. Industrial loan statistics differentiate working capital loans from term loans and further disaggregates term loans into loans to large, medium and small & cottage industries. Both statistics cover loans from scheduled banks and NBFIs.

The following diagram describes the relation between SME loans and industrial loans based on estimates from the outstanding amount of loans as of June 2009.



Source: JICA Survey Team
Note: The amounts shown in the figure above are the outstanding balances as of end of June 2009 estimated based on the existing statistics.

Figure 4-12: Relation between Industrial Credits and SME Credits

The following table compares the outstanding balance of SME loans over the last three years. It should be noted that BB adopted a new definition of SME in May 2008.

Table 4-22: Outstanding balance of SME Loan by type of financial institutions and by sector

Tk Million

Types/ Institutions	Outstanding Balance									
	June 2007	June 2008	June 2009							
	Total outstanding	Total outstanding	Mfg sector		Trading sector		Service sector		Total outstanding	
SCBs	75,118	99,189	94,567	51%	65,534	25%	4,881	16%	164,982	35%
PCBs	129,580	198,898	62,140	33%	171,019	66%	15,613	52%	248,773	52%
FCBs	6,150	6,117	2,310	1%	7,999	3%	1,884	6%	12,193	3%
SBs	26,853	32,491	19,592	10%	9,926	4%	2,635	9%	32,153	7%
NBFIs	9,541	13,677	8,073	4%	3,592	1%	5,186	17%	16,851	4%
Total SME	247,242	350,371	186,682	100%	258,072	100%	30,198	100%	474,952	100%
Share of total			39%		54%		6%		100%	
Avg balance per loan	0.9	1.0	3.8		0.8		2.7		1.2	
Total loan	NA	2,017,408							2,310,654	
% of SME loan	NA	17.4%							20.6%	

Source: BB SMESPD

Note 1: Definition of SMEs was changed in May 2008. The Prudential Regulations for Small Enterprise Financing of BB (First Edition 2004) defines only small enterprises. According to the regulation, small enterprises are an entity, ideally not a public limited company. In the manufacturing sector, small enterprises employ up to 60 persons with total assets at cost excluding land and building from Tk 50,000 to Tk 10.0 million. In the trading sector, small enterprises employ up to 20 persons with total assets at cost excluding land and building from Tk 50,000 to Tk 5.0 million. In the service sector, small enterprises employ up to 30 persons with total assets at cost excluding land and building from Tk 50,000 to Tk 3.0 million.

Note 2: The statistics at SMESPD do not classify the total outstanding balance into small and medium enterprises. BB's Policy Paper 0806 (2008) shows the breakdown of total outstanding SME financing (Tk 213.76 billion) by scheduled bank as of June 2007 as follows: Tk 109.51 billion for small enterprises and Tk 104.25 billion for medium enterprises. Although it is not sure that the definition applied is same as the definition applied in the table above, this statistics show that the amount is almost equally divided into small and medium enterprises.

The total balances of SME loans as of June 2008 and June 2009 was Tk 350.4 billion and Tk. 475.0 billion, respectively. SME loan balances had substantial increases from 2007 to 2009: 41.7 % from 2007 to 2008 and 35.5% from 2008 to 2009[68]. As of June 2009, SME loans accounted for about 20% of the total outstanding amount of banks and financial institutions. BB intends to increase this ratio up to 40%. The trading sector accounted for 54% of SME portfolio and out of the portfolio of the trading sector, the PCBs share reached 66%. In fact, PCB seems to have placed more importance on the trading sector as seen from increasing share of the outstanding balance in the trading sector and the decreasing shares of both the manufacturing and services sectors.

Table 4-23: Share of outstanding balance of SME loans extended by PCBs over the last three years

Sector	FY 2007	FY 2008	FY 2009
Manufacturing sector	27%	26%	25%
Trading sector	66%	68%	69%
Service sector	7%	6%	6%
PCB/Total SME outstanding balance	52.4%	56.8%	52.4%

Source: BB

The following table compares SME loans with the overall bank advances. As the service sector SME statistics seem to relate to more than one economic sector in the overall statistics, SME statistics for the service sector may not be compared with the overall statistics in the same sector. However, so far as the manufacturing and trading sectors of overall banks are concerned, the JICA Survey Team has assumed that the statistics in these sectors basically follow the same classifications. It is estimated that the loans to SMEs account for about 24% in the manufacturing sector and about 35% in the trading sector of the total bank advances.

Table 4-24: Comparison of SME loans to overall bank advances

Tk million

Sector		Balance of bank advances in June 2009	Estimated SME loan balance	Ratio
		X	Y	Y/X
Agriculture		137,538	-	-
Industry/ Manufacturing (Note 2)	Large (Over 150)	580,680	-	0.0%
	Medium (51-150)	160,823	160,823	100.0%
	Small (-50)	23,988	23,988	100.0%
	Cottage	1,871	1,871	100.0%
	Sub-total	767,362	186,682	24.3%
Service		40,586	30,198	74.4%
Construction, Transport & Service		179,718	-	-
Trade		740,452	258,072	34.9%
Other		224,832	-	-
TOTAL		2,090,488	474,952	22.7%

Source: Estimated from the scheduled bank statistics and SME statistics of BB.

[68] These rates of increase may need to be discounted because of different interpretation of SME loans when new definitions and concepts are introduced.

Note 1: The balance in June 2009 shows the scheduled bank statistics that do not include NBFI data unlike SME statistics. However, as NBFIs account for a small portion of loans to SMEs, it can be understood that the comparison in the above table will provide more or less a general picture of SME loans in the overall outstanding balance. For the above comparison to be valid, it is also assumed that the sectoral classification used in the SME statistics is same as the one used in the statistics for the overall bank advances. However, this may not be the case for the service sector as it is related to different sectors of the bank advances like "construction, transport and services."

Note 2: Classification of SMEs in the manufacturing sector is in accordance with the definition adapted in 2008 (See Chapter 3.1).

The balances of bank advances in the manufacturing sector at end of June 2009 are compared to the corresponding sectoral GDP in FY 2009. The sectoral GDP is segregated in proportion to the gross value added by firm size estimated in Chapter 3 using the data from the surveys conducted by BBS in FY 2001-03 and ADB in FY 2007-08. As estimated in the table below, the contribution of SMEs to GDP in the manufacturing sector accounts for about 30% to 35%. The outstanding balance to large firms seems to be bigger than the contributions that they made to GDP and small enterprises seem to have received much smaller amounts in loans compared to the contributions they made to GDP.

Table 4-25: Comparison of bank advances (in June 2009) and GDP (FY 2009) in the manufacturing sector

Size of firms in manufacturing sector (No. of workers)	Balance in June 2009		Proportion estimated using the BBS survey results (2001-2003)			Proportion estimated using the ADB survey results (2007-2008)		
		Ratio	Definition (No of workers)	Estimated proportion of GVA	GDP FY 2009	Definition (No of workers)	Estimated proportion of GVA	GDP FY 2009
Large (Over 150)	580,680	75.7%	100-	55.1%	583,455	Over 150	66.9%	708,511
Medium (51-150)	160,823	21.0%	50-99	28.7%	303,905	51-150	15.0%	159,259
Small (-50)	23,988	3.1%	10-49	6.2%	65,652	10-50	16.9%	178,954
Cottage	1,871	0.2%	Up to 9	10.1%	106,949	Up to 9	1.2%	12,177
Total	767,362	100.0%	Total	100.0%	1,058,902	Total	100.0%	1,058,902

Source: Estimated from the scheduled bank statistics and SME statistics of BB, the survey results of BBS (2001-2003) and ADB (2007-2008)

The statistics for the disbursement of industry by size were available in FY 2009. SMEs, including cottage industries, accounted for 27% (Tk 53 billion) of the disbursement of the industrial term loans during FY 2009 and for 33% of the outstanding amount of loan as of June 2009. A small fraction of the industrial term loans were extended to SMEs, particularly Small Scale & Cottage Industries (4% of the total disbursement).

Table 4-26: Disbursement and outstanding balance of industrial term loans by size of industries

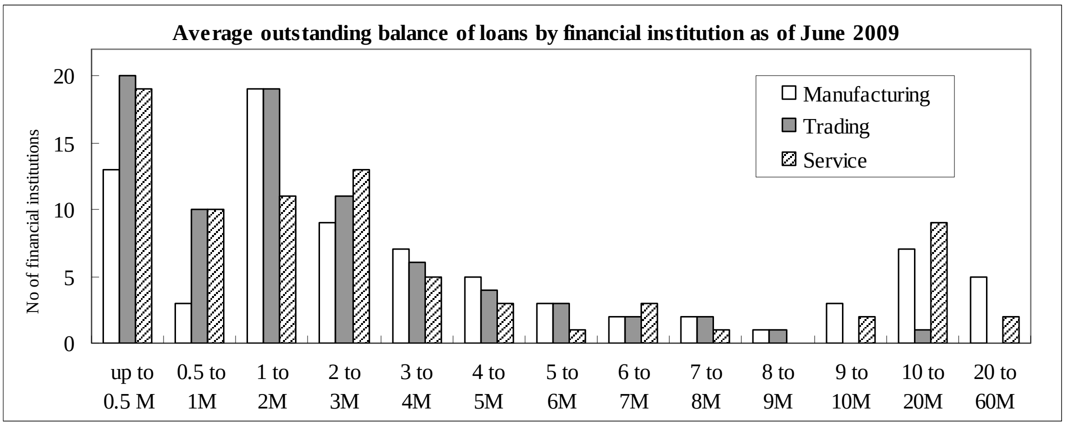
Tk Billion

Type	FY 2009				Total disbursement in FY 2009		Outstanding balance as of June 2009	
	Q3	Q4	Q1	Q2				
LSI	37.43	27.74	30.58	50.91	146.65	73%	320.75	67%
MSI	10.11	10.54	9.96	14.66	45.27	23%	118.35	25%
SSCI	1.97	1.61	1.80	2.42	7.80	4%	38.99	8%
Total	49.51	39.90	42.34	67.98	199.73	100%	478.09	100%

Source: Major economic indicators: Monthly update, BB

Note: LSI=Large Scale Industries; MSI=Medium Scale Industries; and SSCI=Small Scale & Cottage Industries.

According to the SME statistics, the average outstanding amount of loans was calculated at Tk 1.2 million as of June 2009. In terms of sectors, the average balance per loan was Tk 3.8 million for the manufacturing sector, Tk 0.8 million for the trading sector and Tk 2.7 million for the service sector. As of the same date, about 70 banks and NBFIs had a SME loan portfolio. The JICA Survey Team calculated an average outstanding balance per SME loan for each of the banks and NBFIs[69]. Figure 4-13 below shows the distribution of the average outstanding balance per SME loan by banks and NBFIs as of June 2009. From this figure, it can be assumed that a majority of loans is classified into a bracket of less than Tk 3 million. While high concentrations are observed for account sizes between Tk 1.0 and 2.0 million, fewer financial institutions have average loan accounts between Tk 4.0 and at least 10.0 millions. In a sense, SMEs that need this range of loans (from Tk 3.0 million up to at least up to Tk 10 million) are likely to have been underserved. The segment up to Tk 0.5 million represents a smaller proportion also, implying that this segment is not a major areas targeted by banks and NBFIs. These usually extend micro-credits through MFIs under the NGO-linkage program.



Source: SMESPD

Note: Average outstanding balance has been calculated for each of banks and NBFIs that have SME loan portfolios and plotted by sector.

Figure 4-13: Average outstanding balance of SME loans per financial institution as of June 2009

4.6.2 Limited access of SMEs to finance

The previous sections show that SME loans account for only 20% of the total outstanding balance of bank advances with the share of the trade sector being more than half. Comparison of the GDP in the manufacturing sector indicates that the SMEs have received a smaller proportion of the loans compared to their contribution to GDP. In addition, it can be assumed that SMEs that need a range of loans (from Tk 3.0 million at least to Tk 10.0 million) have been underserved. The statistics for industrial loans reveal that only a small fraction of industrial term loans have been extended to SMEs, particularly to small enterprises.

As explained in Chapter 3.2.3 Constraints on SMEs, access to financing is one of the major constraints for enterprises in metropolitan areas while high interest rates for those in non-metropolitan areas.

Difficulties in access to financing can be expressed as in the table below. About 43% of the firms considered access to financing as a major or severe obstacle. The perception of such difficulties among enterprises in metropolitan areas varies depending on size. The smaller the

[69] This analysis should have taken place with individual loan data, not with the average per institution if the relevant data is available.

size, the more enterprises tend to identify access to financing as a major or severe constraint. For instance, in the actual share of loans from a financial institution, about 73% of large enterprises in metropolitan areas have a loan from a financial institution while only 41% of small and 53% of medium enterprises have a loan.

Table 4-27: Percentage of enterprises in metropolitan areas that identify access to financing as a major or severe investment climate constraint according to size, and conditions of SME access to financing

Access to financing	Small	Medium	Large	Sample mean	Median
No. of workers	10-49	50-99	100 & above		
Access to financing (including availability and cost) seen as a major or severe obstacle (% of firms)	51.6%	32.6%	21.7%	42.5%	-
% firms with overdraft facilities/credit line/card	13.4%	42.8%	51.5%	25.3%	-
% firms with a loan from a financial institution	41.4%	53.3%	73.1%	50.8%	-
Maturity of loan at time of approval (months)	29.2	43.9	36.9	32.9	24.0
Annual interest rate on most recent loan	13.5%	13.6%	13.1%	13.3%	14.0%
Collateral needed for a loan (% of loan)	143.0%	159.3%	154.2%	148.1%	140.0%
Internal finance for investment	75.1%	71.8%	59.3%	70.5%	80.0%
Internal finance for working capital	86.5%	81.0%	68.4%	79.1%	1.0%

Source: ICA, 2008 (Appendix 9, Table A9.1)

The maturity of loans was less than 3 years (the median value is 24 months). Loans to small enterprises had shorter maturity periods than those to medium and large ones. The ICA reports that long term financing is typically procured through accumulated earning and thus, firms tend to under-invest in these conditions. The report pointed out a sharp decline in capital stock for metropolitan enterprises in key sectors[70]. It is also noted that the ratio of internal finance for both investment and working capital is high for smaller firms. From the table above, it can be seen that collateral requirements seem to equally affect both large and SMEs with the collateral values being, on average, 1.5 times bigger than loan amounts[71]. As for the interest rate, SMEs pay a slightly higher rate compared with large enterprises.

The following section deals with issues of (1) stringent collateral requirements, and (2) high interest rates as limiting access to finance. Other factors that contribute to such a limited access to finance will be also discussed.

(1) Stringent collateral requirements

The following table shows the outstanding loan amount by types of collaterals. A large portion of the outstanding balance is secured with real estate with financial obligations and also machinery with other fixed assets & financial obligations. From the table, it can be seen that PCBs have stronger preferences for real estate with financial obligations.

[70] The World Bank, Harnessing Competitiveness for Stronger Inclusive Growth – Bangladesh Second Investment Climate Assessment, Bangladesh Development Series Paper No, 25, Oct 2008: P.13.

[71] During interviews at a bank in May 2010, the JICA Survey Team learned that the collateral requirements could be twice as big as loan amounts at some banks, which also required deposits.

Table 4-28: Advances classified by securities as of June 2009

Type of securities	All banks		SCBs	PCBs	FCBs	SBs
	Tk million	%	%	%	%	%
Gold & Gold Ornaments	3.0	0.0%	0.0%	0.0%	0.0%	0.0%
Shares & securities	18,866.7	0.9%	0.0%	1.4%	0.1%	0.0%
Merchandise	226,904.7	10.9%	18.6%	9.0%	13.7%	0.6%
Machinery with other fixed assets & financial obligations	262,646.8	12.6%	18.8%	8.5%	32.8%	8.9%
Real estate with financial obligations	**941,320.6**	**45.0%**	**35.6%**	**53.1%**	**11.4%**	**36.9%**
Financial obligations only (i.e. insurance policies, bank deposits, etc.)	152,022.1	7.3%	2.8%	8.0%	20.3%	2.9%
Miscellaneous (crops, guarantee of individuals, etc.)	420,468.9	20.1%	22.1%	16.1%	21.7%	46.8%
Unsecured	68,253.1	3.3%	2.0%	4.0%	0.0%	4.0%
Total	2,090,485.9	100.0%	100.0%	100.0%	100.0%	100.0%

Source: BB, Scheduled Banks Statistics, April-June 2009

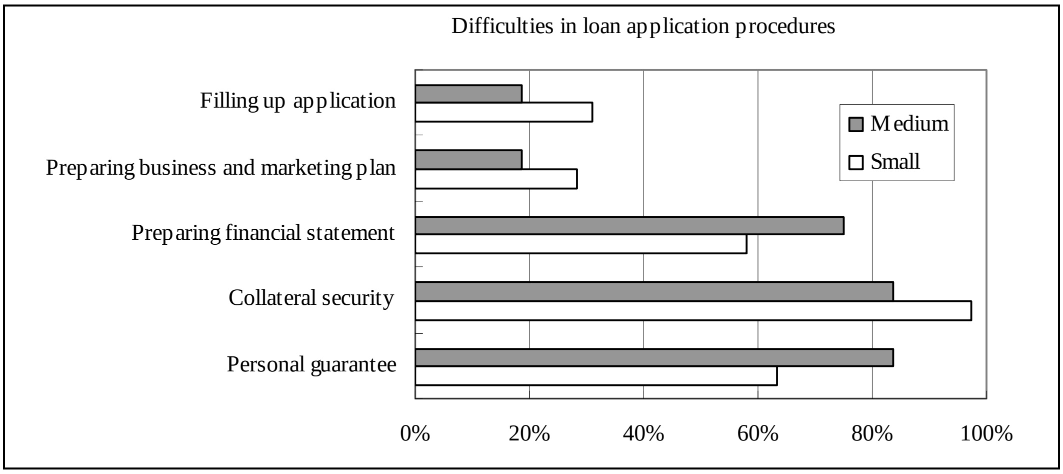
During the JICA survey period, interviews with selected SMEs were conducted (Annex 1).[72] Out of 35 SMEs interviewed, 20 SMEs answered that they had taken on 25 loans in the past. Types of collateral used for these loans were land and building/machinery (16 loans), houses (2 loans), factory assets (2 loans), materials hypothecated (2 loans), etc. Only one loan in the amount of Tk 2.0 million was extended without collateral.[73]

The JBIC study conducted in 2007[74] showed the difficulties that SMEs face in loan application procedures according to size of enterprises. Both small and medium enterprises identified "collateral security," "personal guarantees" as constraints in obtaining loans from banks. The figure below also shows that the preparation of financial statements is another factor that makes the procedures difficult. According to the interviews conducted during the JICA survey period, 31 SMEs replied that they did not prepare an annual business plan. In the case of the financial statements and external audits, only 12 SMEs prepared financial statements every year and 4 SMEs had external auditors audit their financial statements every year.

[72] Interview surveys were conducted by local consultants from April to May 2010. A total of 35 enterprises were visited. The number was far too short for applying statistical inference for generalization and those interviewed were not picked up through the random sampling method. It was intended, however, to obtain a general profile of target beneficiaries at the time of the survey.

[73] Annex 6 shows the average land value per firm based on the sample survey results of ADB.

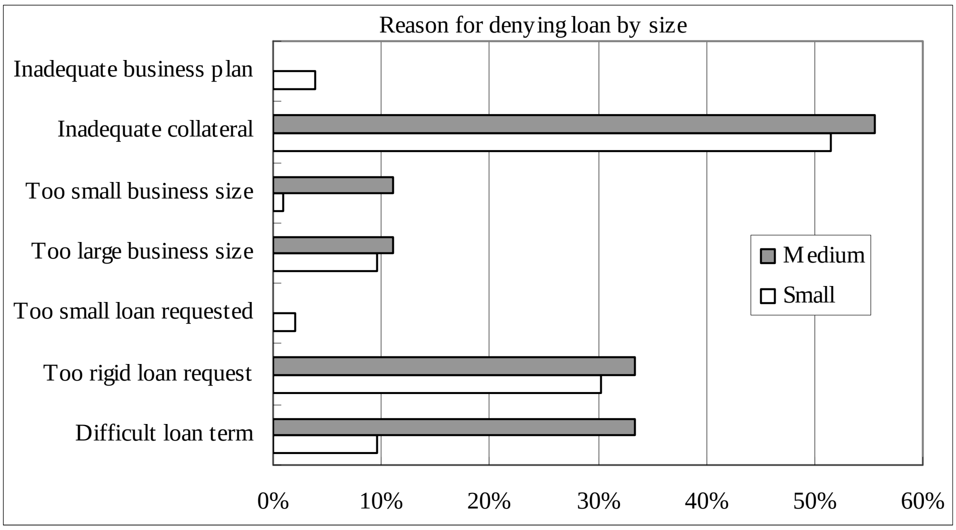
[74] JOBS, "Identifying the Constraints and Needs of Micro, Small and Medium Enterprises (MSMEs) in Access to Finance," Final Report, June 2007, JBIC. The JBIC study defines SMEs based on assets. Total fixed assets of small enterprises range from Tk 5 million to Tk 15 million while those of medium enterprises from Tk 15 million to Tk 100 million. The number of small and medium enterprises surveyed under the JBIC study was 341 and 32, respectively.



Source: Table-6.14 (P.55) of JBIC Survey 2007

Figure 4-14: Difficulties in loan application procedures

The JBIC survey data also shows that loan applications rejected by bank officials were mainly rejected due to "inadequate collateral."



Source: Table-6.21 (P.59) of JBIC Survey 2007

Figure 4-15: Difficulties in loan application procedures

According to the BB prudential regulations for SME financing (2004), banks are free to determine security requirements for loans up to Tk 0.5 million (Chapter 4.5.2 for details).[75] During the survey period of the JICA Survey Team in Bangladesh, one of the PCBs announced a new collateral free loan product up to Tk 5.0 million. However, Tk 5.0 million would be available only from the second year of lending on condition that forty percent (40%) of the loan amount was deposited. In the first year, up to Tk 3.0 million would be loaned with half of the amount being deposited. As this case represents, the larger the size of a loan, the more difficult

[75] This condition is relaxed for women entrepreneurs who are entitled to collateral free loans up to Tk 2.5 million as per ACSPD Circular No.02 dated 18.03.2008. The relevant part reads as follows: "If the borrowers of a lending organization are majority women entrepreneurs and lending against refinancing funds, the banks/financial institutions may consider approval of loans up to Tk 25.00 lacs against hypothecation of enterprise/venture and against personal guarantee."

the access to finance, particularly for small enterprises that are short of physical collaterals but in need of loans larger than Tk 3 million.

(2) High interest rates

In the interviews during the JICA survey, many SMEs expressed their concerns over high interest rates. When they were asked to evaluate the attitude, capability and performance of banks and financial institutions, 25 SMEs out of the 35 interviewed pointed out that banks and financial institutions would charge higher interest than enterprises could bear. In responding to the question about the rate of interest that they would be prepared to pay, 18 SMEs responded with over 5% p.a. but less than 10% p.a. while 7 SMEs said less than 5% p.a.[76]

During the Investment Climate Survey in 2008, high loan interest rates were also identified as a major or severe constraint for enterprises (19% of the firms) located in non-metropolitan areas. As seen in the table below, larger firms tend to regard high loan interest rates as severe constraints presumably because they may have more chance to negotiate for loans than smaller enterprises do.

Table 4-29: Percentage of enterprises in non-metropolitan areas that identify high interest rates associated with loans as major or severe investment climate constraints, according to size, sector and location

By sector and size

Sector	Less than 5 FTE workers	More than 5 FTE workers	Total
Manufacturing	22%	24%	22%
Trading	17%	74%	18%
Services	17%	14%	17%
Total	19%	29%	19%

Source: ICA, 2008 (Appendix 10, Table A 10.41)

Note: FTE stands for Full Time Equivalent.

Through the JICA interviews, it was found out that the interest rates for 25 loans taken on by SMEs ranged from 10% to 20% p.a. The following table shows the interest rates by size of enterprises. Enterprises with workers between 10 and 49 bore higher interest payments than enterprises with workers of 50 or over. However, differences are less than 2% and enterprises with workers up to 9 persons bore less interest payment.

[76] Caution needs to be used when interpreting these responses from SMEs. In consideration of the inflation rate (12 month average inflation rate was 6.26% and the point-to-point inflation rate was 8.78% in March 2010), some of the respondents demanded negative rates of interests in real terms. As seen in this section, the interest rates that SMEs are required to bear may not be necessarily so high if compared with those born by large enterprises. Nevertheless, the JICA Survey Team assumes that their replies conveyed general sentiments of SMEs towards the high cost of funds that they need to pay in doing businesses. Another point that has to be considered in relation to the interest rate is the method of calculating it. Depending on which method to be used, the level of the interest rates is quite different. According to management of a PCB, the level of the interest rate calculated with the declining balance method doubles the “flat rate”. One of women entrepreneurs that the JICA Survey Team visited for interviews showed the repayment schedule of a loan from a NBFI. It showed the single digit service charge (interest rate) of 9% p.a. (flat rate), but with the effective rate of 16.78% p.a. in the bracket next to the flat rate (interview in Mach 2010). According to SMESPD, BB’s refinance scheme does not clearly specify which method to be applied for calculation of interest rates.

Table 4-30: Comparison of interest rates by size of enterprises interviewed

No.	Number of workers	Count	Lowest	Average	Highest
1	Up to 9 persons	3	12%	13.2%	14%
2	Between 10 and 49	16	13%	14.8%	20%
3	50 or over	6	11%	13.0%	15%
Total/average		Total 25	11%	Average 14.1%	20%

Source: JICA survey team
Note 1: When an SME responded with a range of interest rates, an average was taken for the analysis.
Note 2: 12 month average inflation rate (based on CPI) was 6.26 % and the point-to-point inflation rate was 8.78% in March 2010.

The table below compares the interest rates of loans by setting the duration of loan periods more or less equal. Larger firms tend to bear slightly lower interest payments that smaller firms do.

Table 4-31: Comparison of interest rates by size of enterprises interviewed after fixing duration of loans

Number of workers	No. of SMEs	Average interest rate
Loan duration is 12 months or less		
Less than 50	9	14.1%
50 or over	4	13.0%
Loan duration is longer than 12 months		
Less than 50	7	15.4%

Source: JICA survey team

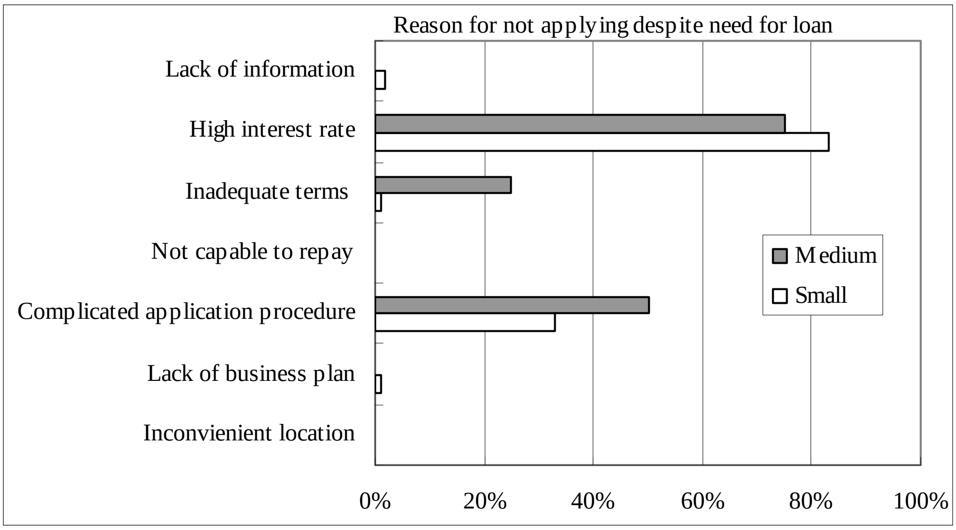
The Investment Climate Survey in 2008 also compared interest rates between enterprises with less workers and enterprises with more workers according to type of institutions. As far as formal institutions like banks are concerned, smaller firms tend to bear slightly higher interest payments.

Table 4-32: Median interest rate

Types of institutions	Less than 5 FTE workers	More than 5 FTE workers	Total
Formal institution-banks	13%	12%	13%
NGOs/MFIs	16%	15%	16%
Samity/other informal	15%	22%	15%

Source: ICA, 2008 (Appendix 10, Tables A 10.30, A 10.32 and A 10.34)
Note 1: FTE stands for Full Time Equivalent.
Note 2: 12 month average inflation rate (based on CPI) was 9.94 % at end of FY 2007-08.

As part of the JBIC survey, SMEs were asked about the primary reason for not applying for a loan when a loan was needed from a bank or MFI. From their responses, “high interest rates” was identified as the most important reason for not applying for a loan although the interpretation of their responses requires caution because they did not even apply for loans. It is also noted that complicated application procedures are another factor that prevented SMEs from applying.



Source: Table-6.24 (P.61) of JBIC Survey 2007

Figure 4-16: Reasons for not applying despite the need for a loan

As seen above, interest payments that smaller enterprises bear may not be so much higher if compared with those paid by larger firms: however, it is understood that smaller enterprises consider the prevailing level of the interest rates quite high in doing businesses even if inflations are taken into account.

As described in Chapter 4.1.2 (3), the National Saving Deposit (NSD) Certificates offer higher returns than deposit rates at the scheduled banks. Since December 2005, the interest rates on 3-year and 5-year NSD Certificates have been set at 11.5% and 12.0%, respectively. The outstanding balance of NSD Certificates as of June 2009 reached Tk 497.9 billion. Higher returns on NSD Certificates make it difficult for banks to mobilize fixed deposits at lower rates. The World Bank points out that these NSD certificates set a floor for the commercial lending rate. Large interest spreads between deposit and lending rates, and banks' preferences to hold low risk assets and businesses are other factors underlying high interest rates[77]. Compared with purchasing of NSD Certificates and loans to large enterprises, banks tend to find higher risks and transaction costs associated with loans to SMEs.

As described above, SMEs have limited access to financing in terms of collaterals, the level of interest rates, repayment period and so on Generally speaking, larger enterprises have better access to financing, but in Bangladesh, it is not only larger enterprises but also micro enterprises that have relatively good access to formal finances thanks to existence of many MFIs. On the other hand, SMEs that wish to grow and scale up from the existing condition tend to be left in the middle segment, and to face difficulties in accessing formal finance. Government supports deem to be required to institute corrective measures.

4.6.3 Financial Institutions for SMEs

Various institutions extend financial support to SMEs. The following section firstly describes the role of BB in promoting SMEs and then gives an explanation of the banks and NBFIs, and SME Foundation.

[77] The World Bank, Bangladesh Economic Update, September 2009.

4.6.3.1 Role of Central Bank in SME Promotion

Aside from the usual role of the central bank, BB has been deeply involved in development-oriented activities, stretching its role to the promotion of SMEs. One of the activities performed by BB has been management of refinance schemes for SMEs, which will be described in the latter part of this sub-chapter. There were three SME refinance schemes in operation at the time of the survey: refinance scheme using BB's own funds; IDA supported refinance scheme; and ADB supported scheme. Using BB's own funds for the SME refinance scheme was agreed as per clause 24[78] of Article 16 of Bangladesh Bank Order, 1972 for refinance of scheduled banks and financial institutions against loans and advances given to the small enterprise sector. Under the BB own fund scheme, the account of the fund appears on the balance sheet under the item "Small and Medium Enterprise Fund - Bank" in Non Statutory Funds. On the other hand, in the case of the refinancing scheme supported by IDA and ADB, BB acts as an agent under an Administrative Agreement concluded with Ministry of Finance. According to BB, the administration of these foreign funds takes place in accordance with clause 1[79] of Article 16 of Bangladesh bank Order, 1972 without increasing high-powered money. In a sense, BB leverages its position as the central bank to monitor the performance of participating financial institutions in these schemes in that BB undertakes inspections on a regular basis and PFIs maintain current accounts with BB, which could be used for the recovery of loans in the event of delayed repayment. Acting as an agent to manage external funds under the refinance schemes, BB balances its role as a catalyst for economic development and a prime actor in maintaining price stability.

The above SME refinance schemes used to be handled by the Agricultural Credit and Special Programmes Department (ACSPD) of BB. ACSPD is entrusted with the responsibility of formulating national agricultural credit policy and its implementation. Their responsibilities also include monitoring and reviewing agricultural credit disbursement and the recovery position of the commercial banks and specialized banks. Income generating activities fall under their supports. However, the characteristics of credit to the agricultural and fishery sector and income generating activities are quite different from the loans to SMEs in terms of loan size, economic sectors, classification in accordance with fixed investment, locations and so on. In order to specifically focus on the activities of SMEs in an integrated manner, BB separated support activities for SMEs from ACSPD, and established a new division called "the SME and Special Programmes Department (SMESPD)", within its head office, at the end of 2009.[80] SMESPD is dedicated to formulating policies and strategies for SME development, refinancing, monitoring of credit activities and to playing a key role in facilitating the growth of entrepreneurs and enterprises. At the time of the survey in May 2010, it was planned that SMESPD would be reorganized so that the department would be comprised of three wings, responsible for administration, special programs like refinance schemes, and monitoring and evaluation (M & E). For the purpose of enhancing the M & E of the refinance program, a consultant has been employed with the support of the International Finance Corporation – South Asia Enterprise Development Facility (IFC-SEFC).

4.6.3.2 Banks and NBFIs

Banks and NBFIs have been supporting SMEs by participating in the refinance schemes

[78] Clause 24 of Article 16 of the said order reads as follows: establish credits and give guarantees.

[79] The said clause was the one substituted by the Bangladesh Bank (Amendment) Act, 2003. The relevant article and clause read as follows: Article 16: The Bank is authorized to carry out and transact the several kinds of business hereinafter specified, namely: (1) [the accepting of money on deposit from and the collection of money for the Government, foreign Governments, domestic and foreign banks, domestic and foreign financial institutions and local authorities with or without interest;]

[80] Based on the interview at ACSPD on March 18, 2010.

managed by BB and by extending loans with their own funds. As described in Chapter 4.6.2, banks and NBFIs, particularly PCBs, have increased their role in extending loans to SMEs. BB concluded participation agreements with 17 banks and 23 NBFIs under the refinance program with its own fund, with 18 banks and 23 NBFIs under the IDA assisted refinance programs, and with 13 banks and 15 NBFIs under an ADB assisted refinance program.

Aside from participating in refinance schemes, there are a number of banks that have been actively promoting SME lending. In order to provide more facilities and better services to SMEs, banks have established SME Service Centers and SME/Agriculture Branches. For example, Brac Bank, one PCB, set up a SME Banking Division. The SME loan portfolio of Brac Bank accounted for about 56% as of end of 2009. The bank has over 429 SME unit offices across the country and 60 online SME sales and service centers. SME Banking Divisions offer 13 loan products and one deposit product.

Among the public financial institutions, BASIC Bank Limited (Bangladesh Small Industries and Commerce Bank Limited) is one of the leading banks that has extended support to SMEs. According to the Memorandum and Articles of Association of the bank, the BASIC bank is obliged to promote the small and medium industrial sector and is mandated to use at least 50% of its loanable funds for financing small and medium industries. Their exposure to the small and medium industries sector accounted for 56.52% of the total loans and advances as of end of 2008.[81]

4.6.3.3 SME Foundation

As part of its efforts to strengthen access for SMEs to finance, SMEF has been implementing a wholesale program. Under the program, SMEF provide funds to banks and financial institutions for relending to SMEs. As of May 2010, SMEF has been implementing the two pilot programs, one with MIDAS Financing Ltd. (a NBFI) and another with Shakti Foundation (a MFI). Details of the pilot programs are shown in Annex 3.

In parallel with implementation of the financing program, SMEF organizes workshops and seminars from time to time. In May 2010, the Foundation organized a workshop named the "lender borrower workshop for SMEs in the leather products sector" jointly with PRICE.[82] The workshop was planned in order to provide a venue for both SMEs in the leather sector and banks & NBFIs so that they could interact with one another and enhance understanding in terms of the specific characteristics of SME finance and SMEs in the leather sector.

4.6.4 Policies on SME Financing

The fundamental development policy of the government is documented in the National Strategy for Accelerated Poverty Reduction II (Revised) FY 2009-11 as mentioned before (Chapter 2.4). The policy stipulates the promotion of higher growth through an adequate flow of capital from the banks to productive activities and to refinance support for income and employment generating priority sectors including agriculture and SMEs, while keeping the lending rate and interest spread low and maintaining a competitive real exchange rate"[83].

In the FY 2009 budget, the government announced provisions to keep the income from the manufacture of SME articles free from taxes while defining SMEs as entities having an annual turnover not exceeding Tk 2.4 million. This had earlier been 2.0 million.

[81] Annual Report 2008 of BASIC Bank

[82] PRICE stands for Poverty Reduction by Increasing the Competitiveness of Enterprises, a USAID-assisted project.

[83] Planning Commission, Government of Bangladesh, "Steps Towards Change: National Strategy for Accelerated Poverty Reduction II (Revised) FT 2009-11", December 2009

In an effort to promote financing to SMEs in line with the country's development policy, BB has formulated and issued prudential guidelines, "Prudential Regulations for Small Enterprise Financing"[84] to be used by financial institutions as was reviewed earlier in Chapter 4.5. To encourage SME financing, the requirements of general provision were reduced from 2 percent to 1 percent on unclassified amounts for small enterprise financing by banks and NBFIs[85].

BB has taken a number of new measures to support the development of SMEs in Bangladesh as described in Chapter 3.3 SME Promotion Policy. Among the various policy measures initiated by BB, this section highlights the following three measures, which are closely relevant to the proposed project: (1) new SME policy; (2) refinancing scheme; and (3) increase in the outreach for SME finance.

(1) New SME credit policy and programs
Upon launching its new SME policy, BB announced a target amount of disbursement according to types of financial institutions. As shown in Table 4-32, the total target is set at (Tk 240 billion = Tk 24,000 crores), out of which PCBs are expected to disburse more than 70%. The total outstanding balance of banks and financial institutions amounts to Tk 2,569.26 billion, out of which loans to SMEs account for about 20% (Tk 511.47 billion). SMESPD of BB considers that this target can be achieved as planned.[86]

Table 4-33: Target amount of disbursement for 2010 by financial institution

Tk billion

Type of financial institutions	Target amount of disbursement in 2010	Share
SCBs	38.97	16.2%
SBs	6.00	2.5%
PCBs	174.78	72.8%
FCBs	7.07	2.9%
NBFIs	13.13	5.5%
Total	239.95	100.0%

Source: BB

In its SME credit policy and programs, BB promotes two approaches: area approach and cluster approach. Under the area approach, financial institutions are expected to disburse SME loans while considering the comparative advantage of the industry in respect of the geographical as well as historical background of the locations. Natural resources favorable in producing certain commodities are also to be considered. In terms of the cluster approach, financial institutions will follow a cluster development policy that aims to strengthen existing clusters, to improve technology, create new clusters in potential sectors, develop skills among entrepreneurs, and so on.

[84] BB, "Prudential Regulations for Small Enterprise Financing", 2004
[85] BB, ""Financial Sector Review" Volume IV, No. 1, January 2009
[86] According to SMESPD of BB, the target of the first quarter in 2010 was achieved although SMESPD had reservations in checking the appropriateness of the target and classification of SMEs loans.

(2) Refinancing schemes

BB considers it more important to enhance easy availability of credits than to respond to frequent complaints about high interest rates. BB has introduced refinancing schemes for the SME sector with its own funds as well as funds from IDA and ADB (Chapter 5.2 for details of ADB amd IDA assisted projects). In implementing the refinancing schemes, BB issued a circular (ACSPD Circular No.01 dated May 2, 2004) to all scheduled banks and financial institutions in the country and informed them of the main features and terms and conditions of the scheme. This circular, titled “Refinance scheme for the small enterprise sector” shows the following specific features of the scheme:

- Definition of small enterprises: an enterprise having fixed assets not exceeding Tk 10 million (=Tk 1 crore)
- Type of sub-loans: working capital (maximum of 1 year maturity period) and term loans (maximum of 3years for medium-term loans and maximum of 5 years for long-term loans)
- Amount of sub-loans: Tk 0.2 million to Tk 5.0 million (Tk 2.00 lacs to Tk.50.00 lacs)
- Interest rate for refinance: BB prevailing Bank rate (currently 5.00% p.a.)
- Interest rate of financial institutions: individual interest rates of financial institutions
- Financial institutions having more than 10% classified loans on their small loan portfolio (loan accounts up to Tk 5.0 million) will not be eligible for refinance

Table 4-34 below compares the status of the three refinancing schemes as of the end of June 2009.

Table 4-34: Results of refinancing scheme for Small Enterprises as of June 2009

Scheme	Amount disbursed as of June 2009 (A) (Tk billion)	No. of Enterprises (B)	Average disbursement per enterprise (A)/(B) (Tk million)
BB' SEF (Small Enterprise Fund)	7.16	7,001	1.02
IDA Fund/GoB Fund	2.25	2,477	0.91
ADB Fund	3.04	1,764	1.72
Total	12.45	12,401	1.00

Source: BB Annual Report 2008-2009

Note: According to BFID of MOF, the amount refinanced increased up to Tk 15.3 billion with the number of beneficiary enterprises of 15,672 as of March 2010.

The total disbursement amounted to Tk 12.45 billion as of the end of June 2009 against 7,001 enterprises, which shows that the average disbursed amount per enterprise was about Tk. 1.00 million. Although the amount of sub-loans is set to range from Tk. 0.2 million to Tk. 5.0 million, it is assumed that the size distribution of sub-loans is concentrated around Tk. 1.0 million or less (description and analysis in Annex 5).

Upon launching its new SME policy, BB reiterated its preference for small enterprises as well as for women entrepreneurs. For sub-loans to women entrepreneurs, BB lowered its sub-loan limit to Tk. 0.1 million and set the concessional interest rate at 5% on top of the Bank rate, i.e., sub-loans to women entrepreneurs bore an interest rate of 10% p.a. Participating financial institutions in the refinancing scheme need to earmark a minimum 10%[87] of the SME refinance fund to women entrepreneurs[88]. BB also increased the limit of collateral free loans up to Tk. 2.50 million on personal guarantee[89] whereas for loans to ordinary SMEs, banks are allowed to extend collateral free loans with amounts up to Tk 0.5 million (=Tk. 5 lacs).[90]

(3) Increase in outreach for SME finance

BB adopted a preferential lending policy to remove obstacles from accessing necessary finance by the SMEs by giving permission to the scheduled banks to open SME service centers which would receive applications and disburse, monitor and recover loans to SMEs. The banks have also been allowed to use SME service centers to receive and deliver foreign remittances and to open separate desks for women entrepreneurs. As of December 2009, banks have reportedly opened 209 SME service centers throughout the country[91]. In 2009, BB advanced the concept of the SME service center to allow the banks to open SME/Agricultural Branches at which a wider scope of business is permitted than at the SME service centers[92]. As of March 2010, 111 such branches have come to existence.

(4) Observation of on-going BB refinance schemes

With a view to formulating a new JICA-assisted project, a number of observations can be made on on-going refinance schemes: 1) treatment of women entrepreneurs; 2) time required for refinance; and 3) rationing by sector. .

1) Treatment of women entrepreneurs

Despite the strong commitment made by BB in promoting women entrepreneurs, measures taken by BB seem in some cases to have worked in a counterproductive way. The JICA Survey Team learned through interviews with officers at commercial banks that as loan demands from women entrepreneurs tended to be seasonal, it was hard for them to satisfy the quota set for women entrepreneurs during a certain time. Because they were unable to satisfy the required percentage allocated to women entrepreneurs, they had no other choice but to give up on requests for refinancing originally planned. The cap placed over the lending interest rate is another example. If a financial institution finds the rate not sufficient enough to cover the perceived credit risks to a borrower, capping interest rates on certain clientele discourages the institution to extend loan support to such a group of borrowers. These observations together with the time required for refinancing, described in the section to follow, may partly explain the fact that the disbursement of the Women Enterprise Fund over the last 2.5 years recorded only Tk. 34.5 million out of the total fund of Tk. 1,370 million.

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87 ACSPD Circular No.06 dated May 6, 2008 on refinancing schemes for women entrepreneurs in small and medium enterprises (SMEs) raised the allocation from 10% to 15% in order to ensure more participation of women entrepreneurs in enterprise development of small and medium industries and trading activities. Among the 15% allocation, at least 40% will be fixed for small women entrepreneurs. However, an ACSPD Circular Letter No.02 dated March 2, 2009 on refinancing schemes for women entrepreneurs in the small and medium enterprise sector revised the rate downward due to unsatisfactory disbursement records, and the banks and financial institutions were advised to lend at least 10% of the total allocated funds for SME to women entrepreneurs. If 10% of the total loan were not disbursed to women entrepreneurs, the refinancing facilities may become unavailable.

88 ACSPD Circular No.01 dated February 7, 2007 on refinancing schemes for women entrepreneurs in small enterprises.

89 ACSPD Circular No.02 dated March 18, 2008 on refinancing schemes of small and medium enterprises for women entrepreneurs in small enterprises.

90 Regulation – 6 Securities under BB's prudential regulations for small enterprises financing (2004).

91 BB, Banking Regulation and Policy Department

92 BRPD Circular No. 6 for regulations of SME Service Center issued on May 4, 2008 and BRPD Letter No. 6 (2009) for functions of SME/Agricultural Credit Branch issued on Nov.5, 2009.

2) Time required for refinancing

Despite the attractive Bank rate offered under the refinance scheme, the JICA Survey Team learned that it took one and a half months to three months to get loans refinanced by BB. Especially in the case of women entrepreneurs, PFIs need to extend low-interest loans with costly funds mobilized by themselves during this waiting period.

With a view to shorting the time required for refinancing, the JICA Survey Team consider it worth studying the concept and procedures adopted at BB's Forex Reserve and Treasury Management Department in the managing of their Export Development Fund (EDF). In order to facilitate exports from Bangladesh, EDF has been used to provide discounting facilities to the scheduled commercial banks financing exporters for the imports of raw materials, accessories, spare parts, packing materials and so on. The amount of EDF, a revolving fund, was USD 300 million at the time of the survey.

EDF was originally introduced in 1988. BB used to review the initial statements submitted by banks, which contains detailed the information of L/Cs issued under EDF guidelines. If BB found incompliance in the statements, BB informed the bank of discrepancies and did not approve the applications. However, because this practice took time and ultimately caused delays in exports, BB decided to change the procedures from the beginning of 2010. Under the new procedures, BB's main task is to confirm compliance of the application with the guidelines[93] while commercial banks are to bear the credit risks. BB basically does not reject application from commercial banks. Export Development Fund Management Software was also introduced in 2007 for data input and management. At the time of the survey, two working days were required to process a request for disbursement from banks.

3) Credit rationing by sector

Another issue that needs to be reviewed is the credit rationing being practiced under the ongoing refinancing schemes. BB rations requested amounts for refinancing by 40% in the case of the trading sector. The rationing has posed a degree of uncertainty on the amount that requesting PFIs receive from BB even after they have concluded a credit agreement with end borrowers. This has caused PFIs to revise terms and conditions afterwards, depending on the decisions made by BB, or to incorporate both case scenarios (loans with refinance and loans without refinance) into the terms and conditions of loans when negotiating new loans. Although it is clearly stated in the participation agreement in the case of ADB-assisted schemes that BB reserves the right to meet refinance claims from Participating Financial Institutions (PFIs) subject to the availability of balance, it will be important to set up clear written rules and share them with PFIs.

4.7 Estimated Financing Gaps for Medium- and Long-term Investment for SMEs

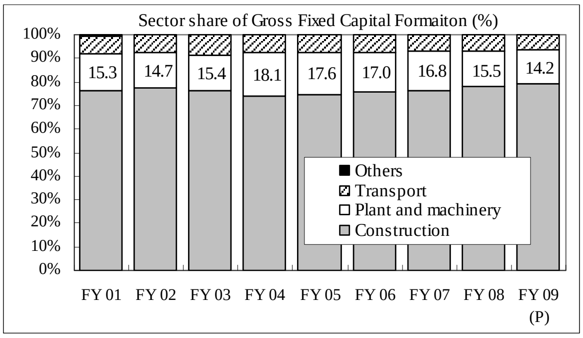
The previous sub-chapter (Chapter 4.6) overviewed the existing conditions in the financial sector for SMEs and then described the financial institutions relevant for SMEs. At the end of the sub-chapter, the policy measures of BB were highlighted. Based on their analysis, the JICA Survey Team indentified the following features of current SME finance in the country:

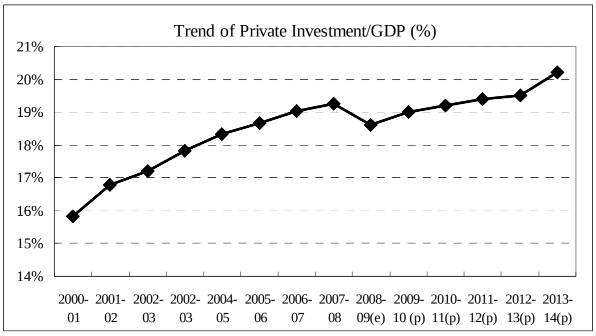
(1) A smaller amount of loans extended to SMEs: about 20 % of the total outstanding balance of loans as of June 2009;
(2) A majority of SME loans extended to the trade sector: 54% of the SME loan outstanding balance as of June 2009; and
(3) It is assumed that the large amount of loans is extended to meet short-term working capital needs.

[93] Guidelines for Foreign Exchange Transactions (GFET).

In consideration of the current conditions of the financial sector for SMEs, this sub-chapter aims to estimate gaps of demands on medium-and long-term investment loans by SMEs and supplies of medium-and long-term investment loans to SMEs by financial institutions. With a limited availability of relevant statistics and data, the JICA Survey Team has made an attempt to estimate: (1) demands on investment loans by SMEs from a macroeconomic viewpoint, based on the trend of gross fixed capital formation; and (2) supplies of loans to SMEs by financial institutions based on a sum of the repayment of medium-and long-term loans as well as the incremental increase in medium-and long-term deposits to be used for medium-and long-term investment loans.

(1) Estimate of demands on medium-and long-term investment by SMEs
As discussed in Chapter 2, the Bangladeshi economy has shown steady growth at an annual rate of around 6% p.a. over the last 10 years. Consumption that accounted for over 82% in FY 1998-99 declined slightly to 80% in FY 2008-2009 with a decrease in private consumption to 74.8% from 77.7% and an increase in general government consumption to 5.2% from 4.6% (Statistics of BBS). The share of gross investment against GDP that recorded 22.2% in FY 1998-99 increased to about 23.3% of GDP in FY 2008-2009 (provisional statistics of IMF), with the private sector and public shares being 18.6% and 4.7%, respectively. In nominal terms, the amount reached about Tk. 1.43 trillion in FY 2008-09 (Tk. 1.14 trillion for the private sector and Tk. 0.29 trillion for the public sector).





Source: BBS (quoted from BB, Monetary policy review, July 2009)
Note: P=provisional

Figure 4-17: Sector share of Gross Fixed Capital Formation

Figure 4-18: Annual growth rate of Gross Fixed Capital Formation

According to a projection recently made by IMF based on data provided by the Bangladesh authorities,[94] the IMF estimate of a real growth rate of the economy in 2008-09 was slightly lower than the provisional figure shown in the BBS statistics for the same fiscal year. However, IMF projected the growth trend of the Bangladeshi economy to continue over the next five years at a rate ranging from 5.0 % to 6% p.a. IMF also projected that private investment would gradually increase from an estimated share of 18.6% of GDP in Year 2008-09 to 20.2% in Year 2013-14.

The growth rate projected by the IMF was used for estimation of the nominal GDP (Row **(A)** in the table below) and the private investment **(B)** in the nominal terms. According to the BBS statistics, the gross fixed capital formation consisted of the following components with their respective shares in brackets in FY 2009: construction (79.37%), plant and machinery (14.19%),

94 IMF, Bangladesh: Financial System Stability Assessment, IMF Country Report No.10/38, February 2010.

transport (6.27%) and others (0.17%).[95] Out of this gross fixed capital formation, it is assumed that 55% is used for productive investment in machinery, equipment, construction of factories, etc. The amount of the productive investment is calculated at Tk 629.04 billion **(C)** in FY 2008-09. By assuming that the share of the investment in machinery, equipment, construction of factories, etc. remains unchanged at 55% of the gross investment in the private sector, the level of investment is expected to reach Tk 1,299.93 billion in FY 2014-15 **(C)**. Only part of this estimated amount of private investment in equipment and facilities would be expected to be undertaken by SMEs with credit extended by banks and financial institutions. If 19 %[96] of the private investment is financed by banks and financial institutions, private investment covered by credit would be Tk 246.99 billion in FY 2014-15 **(D)**. If 35%[97] out of this amount is directed to SMEs, the amount covered would be Tk 86.4 billion in the same fiscal year **(E)**.

(2) Estimate of supplies of loans to SMEs by financial institutions
The lower part of the table shows the supply side of the loans to SMEs. There are two sources of funds to extend medium-and long-term loans to SMEs. One is the amount repaid from borrowers of medium-and long-term investment loans to financial institutions and the other is an incremental increase in the medium-and long-term deposits.

The projection of the outstanding balance of medium- and long-term loans for SME is based on the actual figures for industrial term loans for SME in 2009, together with a projection made in proportion to the growth rate of private sector credit as projected by the IMF. It is projected that the outstanding balance of the industrial term loans for SMEs will increase to Tk 398.09 billion in FY 2014-15. Since term loans are not necessarily used for investment purposes but are often used to meet working capital needs, 55% of the medium-and long-term loans is considered to be used for investment purposes under this analysis **(G)**. It is also estimated that one-fifth of the outstanding balance is repaid every year and used for the disbursement in the following year. Estimated amounts to be disbursed for investment are shown in **(H)** of the table below.

In terms of the deposits, the total amount of deposits is projected as in **(I)**. Based on the data collected from selected financial institutions, it is estimated that the medium-and long-term deposit accounts for 35 % of the total deposit **(J)**. Out of this amount, 20% is expected to be used for loans to SMEs **(K)**. Out of the loans to SMEs, investment loans are estimated at 55% **(L)**. Incremental differences between the amounts in Year X and Year X-1 are taken as in **(M)**.
The total supply **(N)** for loans to SMEs for investment purpose will be a sum of the amounts repaid **(H)** and incremental increase of medium-and long-term deposits **(M)**.

Comparison of demands and supplies of loans will show that a certain level of gaps exists **(O)** although the extent of gaps will be depending upon conditions to be set.

[95] BBS, which has been quoted in BB's monetary policy review, July 2009.

[96] According to the ICA (2008), 16% of firms surveyed responded with the bank finance for investment (domestic), 0.2% of firms with the bank finance for investment (foreign) and 3.5% of firms with the bank finance for investment (state). These percentages are sample means. Based on this estimate, 19% is used as a proxy to estimate the amount of investment that will be done with loans from financial institutions.

[97] The percentage (35%) is based on the BB statistics showing that loans to SMEs account for about 35% of the industrial term loans.

Table 4-35 : Comparison of estimated investment demand and SME loans

Unit: Tk billion

FY	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
Estimate of investment demand by SMEs							
Projected GDP in current prices **(A)**	6,149.0	6,867.0	7,698.0	8,568.0	9,536.0	10,563.0	11,700.6
Private investment **(B)**	1,143.7	1,304.7	1,478.0	1,662.2	1,859.5	2,133.7	2,363.5
(B)/(A) (%)	18.6%	19.0%	19.2%	19.4%	19.5%	20.2%	20.2%
Investment in Machinery/factory etc **(C)**=(B)*55%	629.04	717.59	812.90	914.21	1,022.73	1,173.54	1,299.93
Loans from FIs **(D)**=(C) *19%	119.52	136.34	154.45	173.70	194.32	222.97	246.99
SME demand for investment **(E)**=(D) * 35%	41.8	47.7	54.1	60.8	68.0	78.0	86.4
Estimated source of SME loans (if SME loans continue to be extended in accordance with the growth of private sector credit)							
Estimated M & L loans for SME (Outstanding) **(F)**	157.34	182.04	212.26	247.50	289.82	339.67	398.09
Out of which: Loans for investment **(G)**=(F) * 55%	86.54	100.12	116.74	136.12	159.40	186.82	218.95
Out of which, repayment **(H)**=$(G)^{-1}$/5	14.51	17.31	20.02	23.35	27.22	31.88	37.36
(I)=Total deposit	2,786.8	3,193.7	3,695.1	4,308.5	5,023.7	5,882.7	6,888.7
M/L deposit **(J)**=(I) * 35%	975.4	1,117.8	1,293.3	1,508.0	1,758.3	2,059.0	2,411.0
Loans to SMEs **(K)**=(J)*20%	195.08	223.56	258.66	301.60	351.66	411.80	482.20
Loans for investment **(L)**=(K)*55%	107.29	122.96	142.26	165.88	193.41	226.49	265.21
Incremental increase of outstanding balance **(M)**=(L)-$(L)^{-1}$	18.08	15.66	19.31	23.62	27.53	33.08	38.72
Total supply of loans **(N)**=(H)+(M)	32.59	32.97	39.33	46.97	54.76	64.96	76.08
Estimated amount of gaps in investment loans							
(O)=(E)-(N)	9.2	14.7	14.7	13.8	13.3	13.1	10.4

Source: Estimate of the JICA Survey Team

Note: In order to make projection for FY 2014-15, the same growth rates as used in FY 2013-14 have been applied.

5. Other Donors' Assistance

5.1 Overview

Bangladesh receives assistance from several donors for SME development. ADB and the World Bank extend loans to inject funds into the Bangladesh Bank's refinance scheme. The World Bank, moreover, implements some projects for investment promotion and also private sector development. Much technical assistance using grant funds from several donors has also been conducted in Bangladesh. An outline of each project by major donors appears in Table 5-1 with implementing schedules shown in Figure 5-1.

Table 5-1: Other donors activities

Donor	Scheme	Major activities		Timeframe
ADB	Loan	SME Sector Development Program: 【Project Loan】 A small enterprise fund (SEF) was created by the Government with Bangladesh Bank (BB). Amount refinanced to SMEs from SEF through Participating Financial Institutions (PFIs): ADB contribution of $29.5 million, BB's own contribution of Tk1.00 billion and World Bank funds of Tk500 million were fully utilized. BB also started revolving of realized funds from PFIs. 【Program Loan】 To support policy reform including: 1. SME policy and development framework, 2. Institutional structure and mechanisms to implement the SME development strategy, 3. Action program to support SME development strategy, 4. Rationalized government assistance to SMEs, 5. Tax and Incentives, and 6. Improved SME access to business support services and government assistance 【TA Loan】 1. A web portal was launched on 17 July 2007. 2. Capacity development and training program is on-going. 3. To provide advisory support to facilitate access to government services, and basic office support facilities, and a feedback mechanism for SME concerns, equipment has been procured, and 25 helpline outreach centers in different districts and 6 in Dhaka and Chittagong Divisions were established.	Project loan: $ 30 million Program loan: $ 15 million TA loan: $ 5 million	**December 2004 – June 2010** **(The Small Enterprise Fund (1) was fully utilize by the end of July, 2009)**
ADB	Loan	SME Sector Development Project (II): The project comprises a credit facility for enhancing access to medium to long-term financing through PFIs to eligible SMEs located outside the metropolitan areas of Dhaka and Chittagong.	Credit line: $ 76 million	**October 2010 – September 2012**
World Bank	Loan	Central Bank Strengthening Project: To achieve a strong and effective regulatory and supervisory system for Bangladesh's banking sector.	$37 million	**June 2003 – December 2009**
World Bank	Loan	Enterprise Growth & Bank Modernization: 【Objective】 1) To trigger employment generation through private sector enterprise growth and urgently needed reforms within the SOEs; and 2) To help Bangladesh implement its banking sector reform program aimed at achieving a competitive private banking system by a staged withdrawal through corporatization leading to divestment of a substantial shareholding in Rupali, Agrani and Janata, and to divestment of a minority shareholding in Sonali. 【Project Component】 Seeks to support the development of the small enterprise sector by addressing the constraints that hinder access to finance by this sector on the part of entrepreneurs etc.	$250 million	**June 2004 – December 2010**
DFID World Bank	Loan	Private Sector Development Support Project: 【Objective】 1) Streamlining the regulatory interface between government and business, 2) facilitating the focused provision of land and infrastructural services through an efficient industrial zoning program, and	($ 85 million)	-

Donor	Scheme	Major activities		Timeframe
		3) Building capacity in key government agencies working on PSD issues, such as the Board of Investment, Bangladesh Export Processing Zones Authority (BEPZA) and selected government ministries. 【Next step】 The appraisal is to be conducted in May, 2010.		
EC	TA	Integrated Support to Poverty and Inequality Reduction through Enterprise Development: 1) capacity development of Bangladesh Bank Training Academy through collaboration with European Bank Training Association to train bank regulators on how to improve the regulatory framework that supports enhancing SME access to appropriate and affordable finance 2) capacity development of the Bangladesh Institute of Bank Management through collaboration with the European Bank Training Association to train the management and staff of commercial banks on all aspects of SME banking, including financial product development suitable to SME needs and cash-flow-based lending	€19 million	September 2009 – September 2012
USAID	TA	Poverty Reduction by Increasing the Competitiveness of Enterprises (PRICE): 1) Facilitate the conduction of access to finance workshops for the enterprises 2) Support access to value chain financing for SME producers & suppliers (Outgrowers scheme etc.) 3) Support the Exposure visits for the financial institute to SME/ cluster industries	$11 million	February 2008 – February 2013
[Phase II] Implementation Swisscontact GTZ Fund from SDC DFID CIDA EKN	TA	KATALYST（Developing Business Service Market） Project: Katalyst is implemented under the Ministry of Commerce (MoC) of the Government of Bangladesh by Swisscontact, Swiss foundation for Technical Cooperation and GTZ International Services Target sector: manufacturing, agricultural and service sectors The overall goal of the project was "To increase the competitiveness of small and medium enterprises in selected areas and sectors" through ensuring "An effective and sustainable market for business development services, aimed at SME, emerges". 1) service group 2) industry & rural sectors group 3) rural sectors group 4) business enabling environment group	$ 25million（phase II）	[Phase I] 2003 – March 2008 [Phase II] April 2008- March 2013 The project began in 2003.
DFID IFC	TA	PROSPER: Upgrading the Credit Information Bureau in Bangladesh Bank which will assist eventually in allowing SMEs to access loans based on accurate information and the Automated Clearing House and Electronic Funds Network through the remittances and payments program which in the longer term should enhance the speed of financial transactions across the country.	$6 million	May 2009 – September 2010
IFC-BICF IFC-SEDF	TA	Economic zones: undertake a feasibility study and master plan for SME park with state-of the art environmental migration Support program through improvement of access to finance	 $36 million (phase 2)	July 2009 – September 2010 January 2009 – June 2014

Source: ADB Website (http://www.adb.org/Projects/project.asp?id=35225) as of April 14, 2010, Proposed Loan People's Republic of Bangladesh: Small and Medium-Sized Enterprise Development Project (ADB), World Bank website (http://worldbank.org.bd/), KATALYST project website (http://www.katalyst.com.bd/) as of April 14, 2010, "Donor Interventions that contribute toward PRSP strategic goals" (IFC) and "Survey for SME financing in Bangladesh"（JBIC/Institute for International Monetary Affairs）

Note: SDC the Swiss Agency for Development and Cooperation, DFID the UK Department for International Development, CIDA the Canadian International Development Agency and EKN the Embassy of the Kingdom of the Netherlands

Project	Donor	Scheme			2006	2007	2008	2009	2010	2011	2012	2013	2014
		Loan	Grant	T/A									
SME Sector Development Program (I)	ADB	○ $50 mil											
SME Sector Development Project (II)	ADB	○ $76 mil											
Central Bank Strengthening Project	World Bank	○ $37 mil											
Enterprise Growth & Bank Modernization	World Bank	○ $250 million											
Investment Promotion and Financing Facility	World Bank	○ $50 million									Pipeline (next phase)		
Private Sector Development Support Project	DFID World Bank	○ $150 million							★ appraisal				
Integrated Support to Poverty and Inequality Reduction through Enterprise Development	EC			○									
Poverty Reduction by Increasing the Competitiveness of Enterprises (PRICE)	USAID			○									
KATALYST (Developing Business Service Market）phase II	SDC DFID CIDA EKN (Swisscontact, GTZ)			○									
PROSPER	DFID IFC			○									
Support program through improvement of access to finance	IFC -SEDF			○									

Source: ADB Website (http://www.adb.org/Projects/project.asp?id=35225) as of April 14, 2010, Proposed Loan People's Republic of Bangladesh: Small and Medium-Sized Enterprise Development Project (ADB), World Bank website (http://worldbank.org.bd/), KATALYST project website (http://www.katalyst.com.bd/) as of April 14, 2010, "Donor Interventions that contribute toward PRSP strategic goals" (IFC) and "Survey for SME financing in Bangladesh"（JBIC/Institute for International Monetary Affairs）

Note: SDC the Swiss Agency for Development and Cooperation, DFID the UK Department for International Development, CIDA the Canadian International Development Agency and EKN the Embassy of the Kingdom of the Netherlands

Figure 5-1: Implementing schedule of major donor projects

5.2 Intermediary Loans

5.2.1 Asian Development Bank

5.2.1.1 Project Outline

ADB has assisted the Bangladesh Bank refinancing scheme for SME financing since 2004. SME Sector Development Project (SMESDP) phase I targeted the disbursement completion date at June, 2010 but the actual disbursement was completed by July, 2009. Therefore, the second phase went quickly into preparation and now is in the process of Loan Agreement effectuation.

Both the phase I and II projects aim at accelerating the development of SMEs by improving their access to medium- and long-term credit, and especially in phase II, emphasis is placed on SMEs in rural and non-urban areas by reflecting the experiences of phase I. In phase I, according to ADB, SMEs in Dhaka and Chittagong districts benefited disproportionately from the credit assistance loans[1]. Out of a total of 64 districts in the country, only Dhaka and Chittagong districts utilized more than 50% of the credit line in terms of the disbursement volume. In the same manner, more than 50% of the enterprises which benefitted were located in Dhaka and Chittagong.

Table 5-2: Project Outline

	Phase I	Phase II
Date approved	December 2004	September 2009
Program Loan (status)	USD 15.0 million (completed) - two tranches	
Project Loan (status)	USD 30.0 million (disbursement completed) - refinancing scheme	USD 76 million (in the process of effectuation) - refinancing scheme
TA Loan (status)	USD 5.0 million (partially ongoing) 1) rationalization of government assistance to SME 2) SME web portal and virtual front office development 3) establishment and operation of SME helpline outreach centers 4) targeted SME capacity building 5) upgrading of product certification system 6) integrated SME database development 7) environmental assessment and monitoring	
TA Grant (status)	1) SME Development and Export Expansion (completed) 2) Support Program Implementation and Coordination of SMESDP (completed)	Proposed for approval in 2013

Source: ADB website (http://www.adb.org/Projects/project.asp?id=35225)

5.2.1.2 Loan Scheme and Financial Terms

(1) Implementation arrangements

The executing agency is the Finance Division of the Ministry of Finance (MOF) and the implementing agency is the Bangladesh Bank (BB). The Bangladesh Bank Agricultural Credit

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[1] ADB, Report and Recommendations of the President to the Board of Directors Proposed Loan People's Republic of Bangladesh: Small and Medium Sized Enterprise Development Project, August 2009.

and Special Programs Department will administer the project's credit facility. Although the central program coordination unit (CPCU) in charge of program monitoring and coordination was established in MOF in phase I, the *Report and Recommendations of the President to the Board of Directors* and the Loan Agreement for phase II do not mention this point. In phase I, it was planned that the management facilities of the fund would be transferred in a phased manner from BB to the SME Foundation in order to ensure a sustainable institution structure with private sector participation, once the SME Foundation was established. However, this has not yet materialized and has not been planed so far.

Table 5-3: Functions of the Bangladesh Bank for SMESDP

	BB Functions
1	Submitting information to ADB on potential PFIs, including its assessment on their eligibility under the Project
2	Screening and selecting sub-projects submitted by the PFIs
3	Preparing disbursement projections, collecting supporting documents, preparing withdrawal applications and submitting them to ADB
4	Regularly monitoring PFIs continued eligibility under the Project
5	Monitoring disbursements against estimated PFI targets, and reviewing utilization and repayments of sub-loans
6	Maintaining proper accounts, procedures, and records to monitor the progress of Qualified Sub-projects every 6 months
7	Reviewing and reporting to ADB on the utilization of the Loan proceeds through quarterly progress reports
8	Monitoring the socioeconomic and environmental benefits of the Project

Source: Loan Agreement (Small and Medium-Sized Enterprise Development Project) between People's Republic of Bangladesh and Asian Development Bank, 12 October 2009

(2) Funds flow and sub-loan conditions

Figure 5-2 shows financing arrangements for Phase II. The Government will relend through Bangladesh Bank to PFIs in taka at the Bangladesh Bank prevailing rate for a term not exceeding 20 years.[2] BB shall not finance more than 75% of each sub-project cost. Regarding the remaining part, 15% of the sub-project cost shall be financed by PFI with 10% financed by the enterprise. Rationing by sector of the disbursed amount is not set.

In phase I, the refinance loan periods are following three types; (a) short-term – within 12 months, (b) mid-term – more than 12 months and less than 36 months, and (c) long-tem – more than 36 months and less than 60 months including a 1 year grace period. Refinance claims from PFIs to BB have been made on a "first come first serve" basis. Moreover, rationing by sector and specific issues such as gender were set. According to BB, 100% of claimed amounts were disbursed to the manufacturing sector and the service sector, but 40% of this went to the trading sector. Regarding women's enterprises, a policy was set to allocate 10% of total disbursed amount to sub-projects specifically to them.

[2] According to the Loan Agreement between GOB and ADB on 12 October 2009, the repayment period is stipulated as not exceeding 20 years. The Participating Agreement between BB and PFI for the phase I project stipulated the repayment term as follows:

Short term : Repayable within one year from the date of disbursement in two equal half yearly installments with interest.

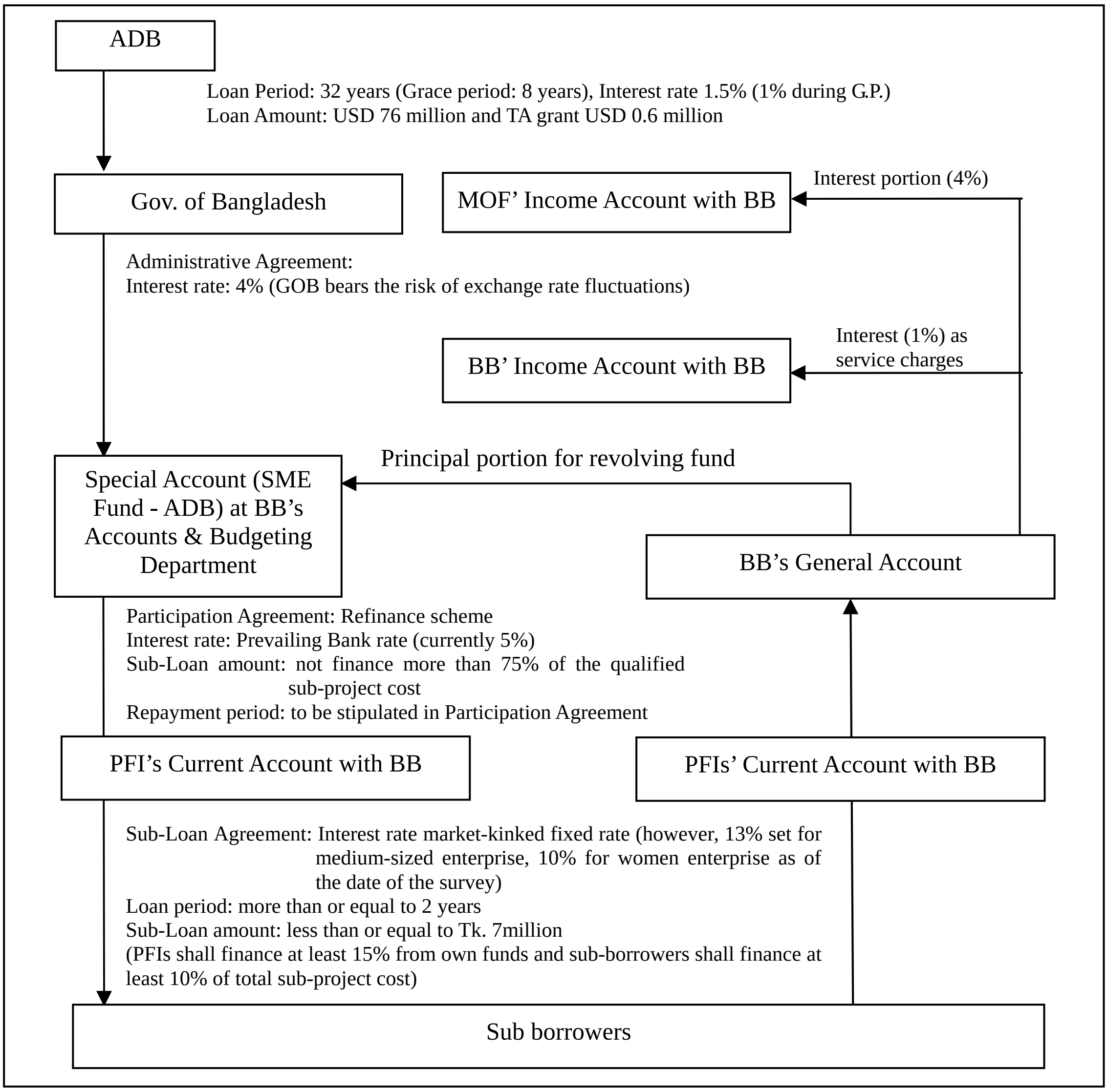
Medium term : Repayable within three years including a -month grace period from the date of disbursement in five equal half yearly installments with interest.

Long term : Repayable within 5 years including a one-year grace period from the date of disbursement in eight equal half-yearly installments with interest.

The Loan Agreement for phase II stipulates as follows on women enterprises: the Bangladesh Bank shall ensure that qualified female entrepreneurs are given preference in accessing financing under the Project by causing PFIs to earmark a minimum of 15% of the Sub-loans for lending to women entrepreneurs; and in the event these funds are not utilized within a period of 2 years from the Effective Date, such funds shall revert to the general pool.

Funds accumulated by recovery of sub-loans are being revolved and re-finance is following the same channel of disbursement as in phase I. The fund had recovered Tk. 998 million as of 31 January 09 and disbursed Tk. 914 million from the revolving fund[3].

In phase II also, a revolving fund will be established in the Bangladesh Bank through funds repaid from PFIs to the Bangladesh Bank.



Source: Loan Agreement (Small and Medium-Sized Enterprise Development Project) between People's Republic of Bangladesh and Asian Development Bank, 12 October 2009, and the interviews with staff at SMESPD of BB
Note: G.P. stands for grace period.

Figure 5-2: Funds flow and financing conditions

[3] ADB, Technical Assistance Consultant's Report, Bangladesh: Small and Medium Enterprise Sector Development Program (Special Fund Resources of ADB), May 2009

(3) PFI Eligibility criteria

Each PFI shall fulfill at all times the items in Table 5-4. In phase I, it was stipulated that eligible PFIs must have no more than 10% classified loans on portfolios up to Tk. 5 million. The high NPL ratio prevented SCBs from participating in the project. However, in phase II, this NPL criterion is planned to be taken out.

Table 5-4: PFI Eligibility Criteria in phase II

	Eligibility Criteria
1	Each PFI shall have a strategy, lending policy, and a track record of performance in respect of SME sector lending
2	Each PFI shall be in compliance with applicable prudential regulations and guidelines of the Bangladesh Bank, including but not limited to those relating to minimum risk-weighted capital; recognition of income; loan classification; loss provisioning; ratio of nonperforming overall loans to nonperforming SME loans; and anti-money laundering
3	Each PFI shall have, and maintain for the duration of the Project, a credit rating of at least BBB- (moderate degree of safety for timely repayment of financial obligations) as per the Bangladesh long term national rating scale of Credit Rating Information and Services Limited[4], or an equivalent rating by a credit rating agency acceptable to ADB
4	Each PFI shall be in compliance with applicable corporate governance regulations and guidelines of the Bangladesh bank, including but not limited to those relating to establishing corporate governance objectives, strategies, structures and techniques to promote effective identification, monitoring, management of material business risks enhancing disclosure, and ensuring compliance with regulatory requirements
5	Each PFI shall have demonstrated capability for lending to SMEs outside Dhaka and Chittagong metropolitan areas, which shall be evidenced by branch operations, lending data, as well as plans or availability for providing credit and advisory services in such areas
6	Each PFI shall have demonstrated capability for proper risk management with adequate processes and procedures covering, among others, credit risk, asset liability risk, and operational risk
7	Each PFI shall have environmental and social safeguards management systems and trained personnel to identify, remedy, and monitor compliance with national and ADB's environmental and social safeguard policies
8	Each PFI shall be financially sound, and shall conduct its operations in accordance with sound financial principles and practices; and maintain a lending and investment policy acceptable to ADB and the Bangladesh Bank to effectively appraise the financial, technical, environmental, and economic feasibility of a sub-project, and supervise and monitor the implementation of the Qualified Sub-projects

Source: Loan Agreement (Small and Medium-Sized Enterprise Development Project) between People's Republic of Bangladesh and Asian Development Bank, 12 October 2009

Note: According to Loan Agreement, Qualified Sub-Project shall: (1) be located outside Dhaka and Chittagong metropolitan areas, (2) be economically and financially viable, (3) be for start-up, expansion, or modernization activities in any of the eligible sub-sectors as agreed between the Borrower and ADB, (4) comply with the Borrower's and ADB's environmental and social safeguard policies, (5) not involve financing of items or activities on ADB's list of Prohibited Investment Activities List, and (6) not involve financing of items or activities that could have a significant adverse environmental impact.

(4) Qualified enterprises

The following conditions on qualified enterprises are stipulated in the Loan Agreement for phase II;

(a) fixed assets not exceeding Tk. 200 million (excluding land and building), or

(b) a workforce not exceeding 150 employees.

[4] Credit Rating Information and Services Limited (CRISL) long-term rating scale range: AAA (Highest Safety); AA+, AA, AA- (High Safety); A+, A, A- (Adequate Safety); BBB+, BBB, BBB- (Moderate Safety); BB;, BB, BB- (Inadequate Safety); B+, B, B- (Risky); CCC+, CCC, CCC- (Vulnerable); CC+, CC, CC- (High Vulnerable); C+, C, C- (Near to Default); D (Default).

(5) Qualified subprojects

According to the Loan Agreement between GOB and ADB on Phase II projects, a qualified subproject shall:

1) be located outside the Dhaka and Chittagong metropolitan areas;
2) be economically and financially viable;
3) be for start-up, expansion, or modernization activities in any of the eligible subsectors as agreed between the Borrower and ADB;
4) comply with the Borrower and ADB environmental and social safeguard policies;
5) not involve financing of items or activities on the ADB list of Prohibited Investment Activities List[5]; and
6) not involve financing of items or activities pursuant to ADB safeguards policies.

5.2.1.3 Technical Assistance

In phase II, technical assistance aimed at the development of women's micro, small and medium-sized entrepreneurship will be conducted through grant funds. Contents of the TA subproject are shown in Table 5-5.

Table 5-5: TA sub-project in phase II

	Planned TA sub-projects
(1)	To help assess constraints and opportunities in women entrepreneurs' effective access to the financial resources made available under the loan
(2)	To support the financial and legal literacy of women entrepreneurs and associations
(3)	To enhance women entrepreneurs' capacity, productivity, and competitiveness
(4)	To promote networking among women entrepreneurs' associations
(5)	To develop a gender-disaggregate database for monitoring and evaluation of the social and gender equality results

Source: ADB, Report and Recommendation of the President to the Board of Directors, August 2009

5.2.1.4 Lessons Learned from phase I and similar projects

According to ADB, the performance of SMESDP phase I was excellent in terms of disbursement and the sub-loan repayment rate. The disbursement from ADB was completed about 12 months ahead of schedule and the sub-loan repayment rate ranged between 93% and 97%. However, considering that a large amount of the funds went to meet short-term working capital requirements, the question was also raised about any value addition that the project made to normal commercial banking operations.[6] The JICA Survey Team understands that this observation was incorporated in the project design of SMESDP Phase II where the sub-loan repayment period was set at more than, or equal to, 2 years and SMEs outside the metropolitan areas of Dhaka and Chittagong were targeted.

As lessons learned from phase I, the regional disproportion in beneficiaries mentioned in 5.2.1.1, and issues on the implementation capacity of BB and PFIs were also pointed out. As lessons from other similar projects, governance issues of finance institutions, including direct lending, weak credit analysis, deficiencies in the monitoring of projects and pricing mismatches were pointed out. Table 5-6 shows the lessons learnt from ADB SMESDP phase I, which the JICA Survey Team considers relevant to the JICA project, proposed measures to be taken by the JICA project, or relevant measures having been already planned or implemented by other donors.

[5] Although it is set out in Supplementary Appendix E to the Report and Recommendations of the President to the Board of Directors, the detailed information is unspecified.

[6] ADB, Technical Assistance Consultant's Report, May 2009.

Table 5-6: Issues and measures raised under ADB's SMESPD Phase I, which could be relevant to the JICA project, and possible counter-measures planned under the JICA project and other donors' assistance

Item	Issues under SMESPD I	Underlying reasons/ factors of such issues	Risks foreseen and measures to be planned under the proposed project	Activities planned/implemented by other donors
1	Central program coordination unit: not working as expected	- Unclear tasks and demarcation	There is a possibility of malfunction of Project Implementation Unit (PIU). It will be important to set clear tasks of PIU and implementing rules and procedures. It is proposed to employ consultant to assist activities of PIU under the proposed JICA project.	--
2	SMEF: not working as expected	- Unclear tasks and demarcation	No specific activities with SMEF have been planned under the project except SMEF's membership of the Steering Committee. As an apex body of SMEs, it is expected to raise voices of SMEs at the Steering Committee. In order to promote the project scheme and capacity development of PFIs, collaboration will be possibly pursed with SMEF	Capacity development to be supported by EC
3	Rationing by sector	- Unclear rules	It will be important to set a clear rule for the management of ODA loan and revolving funds.	--
4	Sub-loans: - Short- & mid-term: 83% (for working capital)	- lack of collateral (SMEs) - lack of appraisal capacity (financial institutes)	There is a possibility that the disbursement does not progress as expected due to slow improvement of access of SMEs to financing. Under the proposed project, it is planned to provide PFIs with low cost and stable funds so that they could promptly put more resources to identify prospective SMEs. Improvement of the management of the ODA loan at PIU is expected to increase convenience of using the project funds. Promotion activities of the loan scheme together with the capacity development of PFIs will also help utilization of the funds. Consultants will be employed to assist PIU in addressing these issues. The Steering Committee will be establish to learn lessons on a periodical basis so that lessons learnt from practical experiences will be fed back into the policy formulation, which will ultimately help acceleration of disbursement.	IFC has been providing TA for capacity development of selected financial institutes.
5	Insufficient project monitoring	- Several parties were involved in the activities. - Unclear tasks and demarcation - lack of capacities	There will be a possibility that the monitoring and evaluation are not adequately carried out. Under the proposed project, PIU will be tasked to conduct the monitoring and evaluation of the project with supports from the consultant.	--
6	Capacity of executing agency/ implementing agency (MOI):	- lack of knowledge of project management/	There are a number of risks foreseen under the project, such as possible delay of employment of consultants, delay of establishment of PIU with full-time Project	--

Item	Issues under SMESPD I	Underlying reasons/ factors of such issues	Risks foreseen and measures to be planned under the proposed project	Activities planned/implemented by other donors
	- delay of consultant recruitment - weak project management - lengthy process of loan administration	procurement (recruitment of consultants) - lack of experience of consultant recruitment/ loan administration	Director and qualified staff members. The establishment of the Steering Committee could be also delayed. It is importance for BB to take an initiative to make institutional arrangements ahead of time. Since this is the first time for BB to implement JICA assisted loan project, it would be worth considering that JICA extend Special Assistance for Project Implementation to accelerate these arrangements.	

Source: For issues and analysis of underlying reasons and factors, reference was made to ADB, Report and Recommendation of the President to the Board of Directors, August 2009, ADB, Technical Assistance Consultant's Report, May 2009.

In order to address the issues related Central Program Coordination Unit (Item 1), slow disbursement (Item 4), insufficient project monitoring (Item 5) and insufficient capacity of executing agency/ implementing agency (Item 6), the roles of consultants will be very important. In addition, as ADB consultants pointed out, it should be worth considering that direct supports be extended to BB through external consultants in order to assist the employment of consultants for the project. Although most of the comments by ADB consultant are based on experiences in Ministry of Industries, those could be also relevant to BB as the proposed project will be the first time for them to manage the JICA two-step loan.

Moreover, the following points were noted as recommendations for efficient and effective SME financial intermediation[7];

(1) creating a conducive policy and regulatory framework to ease constraints on SME finance and private sector development;
(2) developing a broad-based, competitive, and efficient financial sector to provide entrepreneurs with alternative sources of investment capital, a diversified selection of new and innovative products, competitive rates, and efficient services to make their investments viable; and
(3) promoting SME support services such as skills, trades, entrepreneurship, and other business development services.

5.2.2 World Bank

The World Bank has provided several loans for SME development in Bangladesh, such as the Enterprise Growth & Bank Modernization Project and the Private Sector Development Support Project[8]. Above all, one component of the Enterprise Growth & Bank Modernization Project aims at addressing constraints that hinder access to finance by small enterprises. The fund established in this component was originally the existing Agricultural Credit Window of the Bangladesh Bank refinance scheme, which had around Tk. 1.41 billion undisbursed funds. The World Bank made this available for small enterprise lending by amending certain eligibility criteria.

[7] ADB, Report and Recommendations of the President to the Board of Directors, August 2009

[8] Please refer to Table 5-1: Other donors activities on outlines of Investment Promotion and Financing Facility and Private Sector Development Support Project.

5.2.2.1 Basic operating principles of the Small Enterprise Fund

The basic operating principles of the Small Enterprise Fund are as follows[9]:

(1) Total Fund: USD 27 million (the remaining fund left within the Agricultural Credit Window USD 17 million + IDA resource USD 10 million)

(2) Scheme: refinance loans made by financial institutions (commercial banks and non-bank financial institutions) to sub-borrowers

(3) Eligible financial institution criteria: at least 90% loan recovery rate for the end-year portfolio below Tk. 5 million

(4) Interest rate: (BB to financial institutions) BB refinancing rate
(financial institutions to sub-borrowers) no restriction

(5) Conditions: no restriction on the sector
no distinction between term loans and working capital loans
no restriction on the geographical location of business
an upper ceiling of each sub-loan of Tk. 5 million

(6) Loan Administration: The fund will be administered on a reimbursement basis by BB, based upon disbursement and recovery statements provided by financial institutions. Each financial institution will have to present a realistic projected fund requirement over a six month period so that fund managers have a realistic idea of future fund disbursements. BB will set a guaranteed processing time for each loan disbursement once a completed application for funds is received from financial institutions.

(7) Public Relations Activities: The fund will be publicized widely during its launch and periodically afterwards in order to ensure awareness of this facility among financial institutions.

5.2.2.2 Lessons Learned from the Small Enterprise Fund of Enterprise Growth & Bank Modernization Project

According to the World Bank staff, the Enterprise Growth & Bank Modernization Project of IDA achieved good results. Recovery rates were excellent. The average amount of loans ranged from Tk. 700,000 to 800,000, although the possible loan amount was from Tk. 300,000 to Tk. 5 million. Sub-loans were mainly extended to enterprises located in and around Dhaka.

The key for success is that the project design was simple. In traditional refinancing schemes, since target beneficiaries were limited and many conditions were imposed, in the result was often inefficiency in project implementation. One of the future issues to be considered is how to assure sustainability. It is necessary to provide solutions to problems such as the risks of lending to SMEs, limited available collateral on the part SMEs, and assistance to enterprises located in rural areas. As the final interest rate from financial institutions to end-users is high compared with the refinance rate, namely the spread is large, there is the criticism that financial institutions are enjoying large benefits out of it. It is necessary to develop a competitive environment where end-users can choose which financial institution to borrow from.

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[9] World Bank, Project Appraisal Document for an Enterprise Growth and Bank Modernization Project, May 11, 2004

5.3 Technical Assistance

5.3.1 IFC

IFC has mainly provided direct support to the private sector in Bangladesh aiming at improvement of the investment climate with emphasis on (1) private infrastructure, (2) energy, (3) manufacturing and service sector companies, and (4) innovative private sector sponsored projects in health and education. Regarding SME development, IFC provides technical assistance to financial institutions, SMEs and the professional service firms that support the SMEs through the South Asia Enterprise Development Facility (SEDF). IFC also assists the Government of Bangladesh in reforming its investment climate through the Bangladesh Investment Climate Facility (BICF), launched in 2007. Moreover, IFC provides some technical assistance in cooperation with other bilateral and multilateral donors. Table 5-7 shows the programs of SMEs development provided by IFC together with the program outlines.

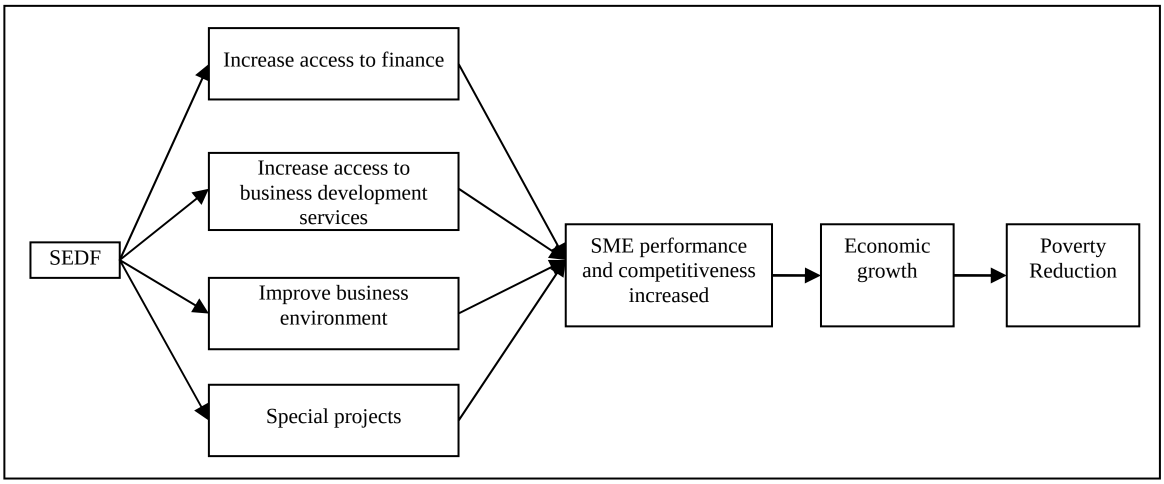
Table 5-7: IFC's TA programs

Scheme	Program	Description
IFC-BICF	Stakeholder Engagement Program	Building the capacity of a PPD forum to form recommendations for the SME sector which are specific, measureable, action-oriented, results-based and time-bound (SMART) in nature Building the capacity of private sector association to advocate reforms Supporting the establishment of Investment Climate Departments in 5 private universities
	Regulatory Reform Program	Supporting RRC to reach out to SMEs and rural business. Helping RRC in designing a regulatory framework appropriate for the growth of SMEs.
	Economic Zones	Undertaking a feasibility study and master plan for an SME park in collaboration with the SME Foundation (July 2009 – September 2010); the SME Park should meet international standards for infrastructure and services.
IFC-SEDF	Seed	Strengthening and linking seed farmer groups to the formal supply chain resulting in the use of better quality inputs and adaptation of better processes.
	Poultry	Productivity improvement and waste management of SME poultry farmers
	Textiles	Productivity will be improved in WDF firms through the adaptation of new technologies and systems Work will be done with relevant associations and service providers to promote the installation of ETPs to ensure environmental compliance
	Financial sector	The capacity of Bankers, Service Providers, Training Institutes, Bangladesh Bank will be enhanced in SME Banking, Risk management, IT, Sustainable Energy Finance, Leasing, Trade Finance
	Sustainable Energy Financing	Work will be done with a cluster of banks to help them develop their SEF portfolios thereby providing loans to SMEs to invest in more energy efficient technologies
IFC-DFID	Credit Information System	Establish on-line credit information system

Source: Donor Interventions that contribute toward PRSP strategic goals (IFC)

(1) SEDF

SEDF aims at economic growth for poverty reduction through SME performance and competitiveness increased by 1) increasing access to finance, 2) increasing access to business development services, 3) improving the business environment, and 4) special projects. SEDF will be continued until June 2014.



Source: "Symposium on Making SME Finance Profitable, IFC's Experience in Facilitating SME Finance" January 2004 (IFC)

Figure 5-3: SEDF Schematic Model

SEDF's TA and training activities are as shown in Table 5-8.

Table 5-8: SEDF's TA and training activities

Technical assistance to PFIs	• Diagnostic study • Strategy re-formulation with SME focus • New product development (factoring) • Introduction of new methodologies (credit scoring) • Credit risk management • IT implementation • HR policy
Generic training	• Risk mitigation (five core areas) • Reconstruction of financial statements • Credit scoring for SME finance
Training to SME & policy work	• Corporate governance • Workshop on writing bankable business plans for SME entrepreneurs • Study on impact of WTO on Bangladesh Financial sector post January 2005
International best practices	• International best practices study tour for PFIs • Portfolio risk management • Risk based pricing

Source: "Symposium on Making SME Finance Profitable, IFC's Experience in Facilitating SME Finance" January 2004 (IFC)

In terms of assistance for the financial sector, IFC selected twelve banks as target institutions and provided technical assistance to introduce SME concepts in phase I. In phase II, IFC set criteria for more selective targets, such as focus on SME financing, shearing of necessary costs for consulting fees[10], and corporate governance. IFC now assists three financial institutions, Brac Bank, Eastern Bank and United Leasing through SEDF. For Eastern Bank, for instance,

10 A cost sharing scheme has been introduced since the latter half of the phase I project.

IFC assisted in the establishment of an SME Department and its strategy, in staff training and in IT during SEDF phase I.

SEDF supports not only the above mentioned individual banks but also the Bangladesh Bank (BB)[11] and the Bankers' Association. IFC discusses with BB, in particular, SMESPD on study tours, deposit mobilization, credit scoring and survey. IFC has dispatched a consultant for the introduction of a Monitoring and Evaluation (M&E) system in SMESPD initially for six months, which could be extended for another six months depending on necessity. The main task of the consultant will be to introduce the M&E system such as the setting of monitoring indicators and the monitoring method.

In addition, IFC collaborates with the SME Foundation and PRICE[12] in order to introduce clusters in the leather industry to financial institutions. Financial institutions in Bangladesh do not have sufficient knowledge of technical aspects of the leather sector, making it harder for them to judge the sector viability. This activity is expected to expand the ability of financial institutions to appraise several sub-sectors of SMEs.

(2) SME Banking Module

Aside from SEDF, IFC and the World Bank Institute with financial support from the Government of Japan developed SME Banking Modules in order to help bankers develop financial products to improve access to finance for SMEs. IFC plans to allow the Bangladesh Bank Training Academy (BBTA) acquire a user license for the modules so as to introduce them in Bangladesh. IFC supports BBTA on training for trainers and on implementation skills for training programs. This TA program will continue until December 2011.

5.3.2 KATALYST Project

The Katalyst project is implemented under the Ministry of Commerce of the Government of Bangladesh by Swisscontact and GTZ International Services. The project phase I, from 2003 to March 2008, was funded by DFID, SIDA, and SDC and phase II, from April 2008 to March 2013, is funded by SDC, DFID, CIDA and EKN.

Katalyst is a Market Development Project aiming at a contribution to poverty reduction in Bangladesh. Features of the intervention are 1) horizontal viewpoints such as cross sector assistance, 2) vertical viewpoints such as a value chain approach, and 3) holistic viewpoints such as those concerning environmental issues (Figure 5-4). The project focuses on sectors with high growth potential in terms of job creation, productivity, profitability and export potential. Katalyst works in the manufacturing (furniture), agricultural (fish, prawn, agro-inputs/seeds & fertilizer, vegetable, maize, and potato) and service sectors (tourism) to create or nurture growth opportunities and remove constraints by strengthening public and private business services and improving the business enabling environment. Target beneficiaries are not necessarily SMEs. For the project, an enterprise means a farmer, a trader and small-scale manufacturer.

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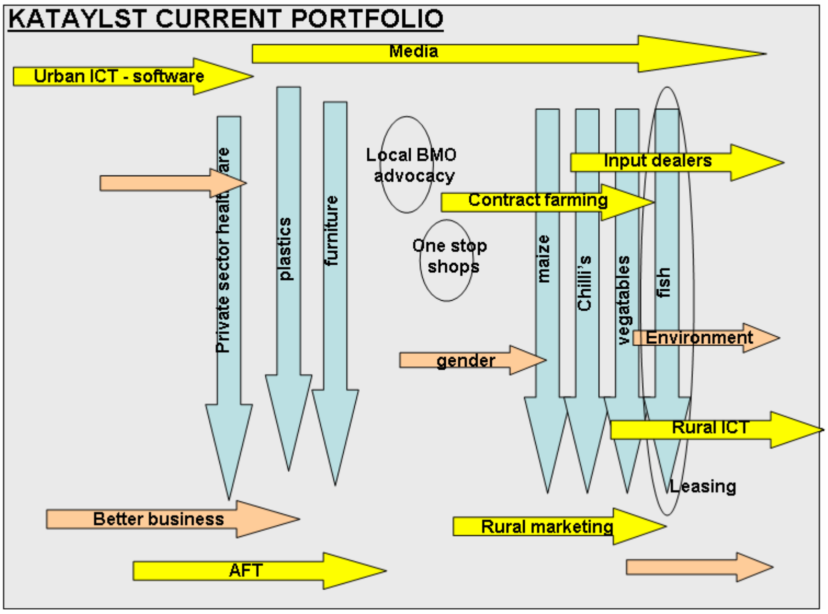
[11] IFC provides assistance to departments for CIB, Anti-money laundering, SMESPD, BBTA etc.

[12] PRICE is one of the USAID funded projects.



Source: Katalyst Business Plan 2009-10

Figure 5-4: KATALYST project portfolio

5.3.3 USAID

(1) Economic Development and Growth with Equity (EDGE) activities

USAID has been implementing the Poverty Reduction by Increasing the Competitiveness of Enterprises (PRICE) project. The project objective is to move its private sector from a situation where it is underperforming to one where it is globally competitive by providing technical assistance and managerial advice to entrepreneurs and associations. Working with both the private and public sectors, the project team will select three sectors on which to focus, namely leather, horticulture and aqua culture, and will develop models for other sectors. Within those sectors, the project team will train businesses and entrepreneurs in management, marketing, finance and accounting, and operations. The team also will introduce new processing technologies and new management systems and will create linkages between the private sector and research institutions, including universities. In addition, USAID implements the Policy Analysis Monitoring and Assessment (PAMA) project, which reviews policy related issues, impact evaluation of PRICE, and contribution to the poor. These two projects comprise Economic Development and Growth with Equity (EDGE) activities. The project implementation term for PRICE is from February 2008 to 2013. The project cost is USD 16.45 million in total, USD 11 million and local currency equivalent to USD 5.45 million (counter fund).

(2) Greater Access to Trade Expansion (GATE) project

The Greater Access to Trade Expansion (GATE) project was financed by the USAID WID Office and it implemented sector studies such as an analysis of impact on gender in the shrimp sector, migrant women workers and free trade. The results are utilized in the PRICE project.

(3) Guarantee scheme for SMEs

USAID introduced the guarantee scheme Phase I in 2000. Participating banks in Phase I were Prime Bank, National Bank and Dhaka Bank. The amount of guarantee was set by USD 1 million and 50% of principal is guaranteed by USAID. The ceiling of the loan amount for each project was Tk. 7,500,000. Eligibility criteria included new loan applications, existence of repayment risks and shortage of collaterals.

There were four cases of subrogation of debt repayment in total. In two cases out of these four, USAID were reimbursed from SMEs.

Phase II started from 2003. In phase II, USAID guarantees the loan targeted at filling stations for compressed natural gas through the Prime Bank and HSBC. This scheme is a Loan Portfolio Guarantee but USAID also reviews individual loans.

Under this scheme, financial institutions pay 0.5% of the guarantee amount as an upfront origination fee and pay biannually a utilization fee based on the outstanding balance. USAID calculates the utilization fee from the participating financial institution in view of the CAMEL rating and sovereign risk.

USAID Dhaka Office pays a subsidy, which is considered as the reinsurance fee, to US Treasury. USAID bears this cost rather than collecting from each financial institution.

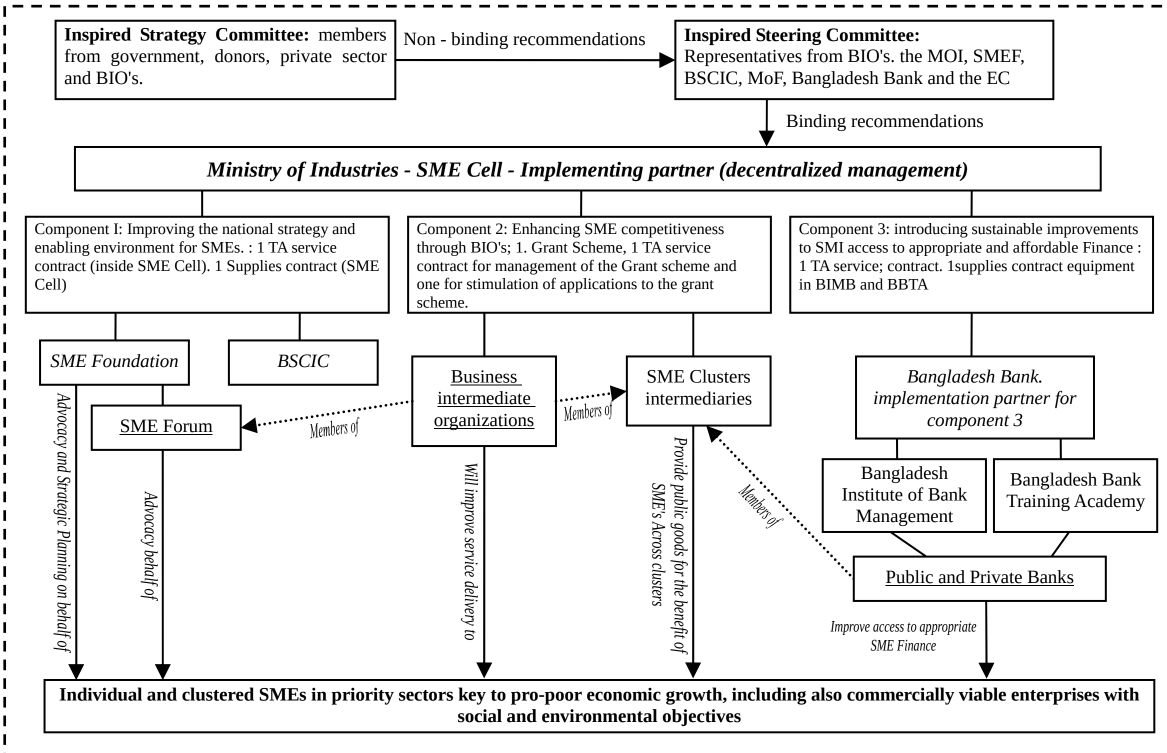
This guarantee scheme will be completed by September 2010 and the next phase will not be planned. It is not known why USAID decided not to continue the scheme. According to an officer in charge at USAID in Dhaka, the scheme was able to draw attention of concerned parties like banks to SME finance as evidenced from establishment of SME banking divisions/units at banks and introduction of refinance schemes at BB.[13] The JICA Survey Team understands that the guarantee coverage would increase the amount of premiums that borrowers need to pay to banks. Especially for small enterprises, an increase in total charges seems to have worked as a counter-factor to utilize the facilities even though they found it easier to access to loans. Coupled with an amount of the workload required for the facilities on the side of USAID, USAID may find it good time to exist after completion of the second phase of the ten year-long project.

5.3.4 European Commission

EC has just started Integrated Support to Poverty and Inequality Reduction through Enterprise Development (INSPIRED) projects since 2010. It is planned that these are completed by 2014. The total project cost is EUR19 million. There are two schemes, 1) technical assistance with capacity building of governmental institutions by consultants and 2) grant schemes, such as the development of a training course for trade associations and the implementation of projects and surveys.

The project scheme is as shown in Figure 5-5.

[13] Interview at USAID in Dhaka on May 4, 2010.



Source: European Commission

Figure 5-5: Project Implementation Scheme

The Counterpart agency is the SME Cell in MOI. Moreover, an Inspired Steering Committee which will give binding recommendations to the SME Cell and an Inspired Strategy Committee which will give non-binding recommendations to the Inspired Steering Committee will be established. The former will consist of MOI, SMEF, BSCIC, MOF, BB and EC. The latter is expected to consist of donor agencies. JICA could be a member of the latter committee depending on needs and requirements.

There are three components in terms of implementation:

Component 1, development of SME strategy and capacity development of SMEF and BSCIC,

Component 2, advocacy activities by trade association in the areas of providing better service and laws or ordinances, and

Component 3, training for BBTA and the Bangladesh Institute of Bank Management in order to improve access to finance and develop laws or ordinances on SMEs.

5.4 SME Need for Assistance

In consideration of lessons learnt from other donors' activities, it is considered necessary to develop the capacity of BB and PFIs for smooth implementation of the project. Moreover, it is important to develop the capacity of SMEs to enhance the efficiency and sustainability of the sub-project through collaboration with other donor agencies.

(1) Capacity Development of the Implementing Agency

In phase I of the ADB SMESDP, it was seen that PFIs raised concerns about the time it took to receive funds in their account after the applications were submitted. It took about one and half month to three months from forwarding applications to receiving funds on average at the beginning of the project. During the implementation of the ADB project, the institutions concerned, especially BB, learned the administration procedures for the loans. However, this was the first time for them to administer a JICA two-step loan. Therefore, it is worth considering the establishment of a Project Implementation Unit with a full-time manager and staff members in order to accumulate knowledge and experience of all the relevant issues and to implement the project efficiently and effectively. It is also deemed necessary to develop the capacities of institutions/agencies involved with loan administration through seminars on JICA procedures for loan administration and on-the-job training by international consultants.

Consideration is also being given to collaboration with the IFC project for the establishment of an M&E Wing in SMESPD in the area of staff training and to utilize this wing for impact surveys and M&E of the proposed JICA Project. Lessons learnt would give feedback into policy formulation for SME finance.

(2) Capacity Building of SMEF

SMEF could be one of the candidates for a bridge agency for technical assistance. In particular, there is the possibility of collaborating with SMEF[14] on finding potential women entrepreneurs and strengthening their capacity. However, the capacity of SMEF is still unclear and at the same time the demarcation of the role and responsibilities in the implementation of SME policy between SMEF and BSCIC is also unclear. Therefore, it is important to clarify the role and responsibilities of SMEF, devise an effective scheme for project implementation, and secure an adequate number of trained personnel. EC will provide TA for the capacity development of SMEF and BSCIC as a part of INSPIRED project. It is worth exchanging information and cooperating with EC on the capacity development of SMEF.

(3) Capacity Building of PFIs on SME financing

ADB pointed out that commercial banks in Bangladesh need a greater capacity for loan funds to SMEs. Increasing access to finance for SMEs requires a diversification of loan products, and the establishment of credit risk assessment which is different from practices developed for corporate customers, and the setting up of an effective loan administration process with control over costs of administration. However, technical assistance for this purpose was not provided by the ADB project.

On the other hand, some banks have been actively involved in the SME finance and supporting activities to SMEs, and training their staff in the relevant fields with their own initiatives. Their activities include establishment of SME banking division, SME sales and service centers in local areas, development of loan and deposit products and training of their staff in SME finance. One of the SCBs that the JICA Survey Team visited was sending their staff to attend training courses at a PCB that is well known for SME financing.

An official of another PCB referred to lack of financial statements and shortage of collaterals as important reasons behind limited access of SMEs for finance: however, he stressed that instead of declining loans to SMEs because of insufficiency in the requirements, they tried to train their bank staff so that their staff could prepare necessary financial documents through observing the daily business transactions at SMEs.

In addition to the efforts of banking sector, IFC provides technical assistance to build the capacity of bankers, service providers, training institutes, BB in SME banking, risk management, IT, sustainable energy finance, leasing, and trade finance through SEDF. For PFI capacity

[14] SMEF has several experience in the areas of women entrepreneurship development as follows;
(a) institutional capacity building of the women's chambers; (b) national women entrepreneurs' forum; (c) the national SME women entrepreneurs award; (d) credit for women entrepreneurs (especially gender sensitization of bankers) and so on.

building on SME financing, it is worth planning to formulate part of the TA under the project in collaboration with IFC.

Moreover, the JICA Survey Team received the following comments on the needs of financial institutions' capacity building from an official at Dhaka Chamber of Commerce and Industry (DCCI). She made remarks on importance of meeting SMEs' needs to prepare a business plan from a long-term viewpoint. DCCI held a business matching fair in 2009 inviting Government officials, staff of financial institutions and SMEs. Officials from the Bangladesh Bank Training Academy (BBTA) also mentioned areas that would require capacity development of financial institutions. The areas include identification of SME entrepreneurs, selection and appraisal of borrowers, development of SME related products, monitoring and evaluation and TOT of BB staff[15].

In terms of women's empowerment, ADB will assist the development of women's micro, small and medium-sized entrepreneurship as TA subproject grant support. It will help assess constraints on and opportunities for women entrepreneurs' effective access to financial resources made available under the loan and then directly support women entrepreneurs or associations.[16] It is worth considering ways in which PFIs could assist women entrepreneurs in collaboration with SMEF and the Bangladesh Women's Chamber of Commerce and Industry (BWCCI) by enhancing PFIs' capacity to discover potential women entrepreneurs and empowering them.

(4) Capacity Building of SMEs

It is planned to address needs of SMEs through capacity building of BB and PFIs, and through collaborating with other donor agencies, particularly those extending technical cooperation, and domestic supporting organizations such as a chamber of commerce and industry.

During the interview survey with selected SMEs conducted from April to May 2010, SMEs were asked to point out areas that they wished to receive guidance in terms of financing and bank borrowing. Many SMEs responded with concrete and practical requests such as investment planning and evaluation, financial management and preparation of loan application and financial statement. No SMEs surveyed needed introduction of banks and financial institutions. In fact, it was found out that all the SMEs surveyed had already opened accounts at banks and or financial institutions. However, with regard to preparation of an annual business plan, 31 SMEs replied that they did not prepare it. In case of the financial statements and external audit, only 12 SMEs prepared the financial statements every year and 4 SMEs had external auditors audit the financial statement every year. Development of business plans, bookkeeping and the preparation of financial documents for SMEs will be important areas that need to be strengthened.

In terms of management, SMEs were asked to choose types of guidance and assistance they wish to receive. Their response revealed that workers' training was the area as many as 22 SMEs pointed out. This is followed by technical advice on production management and production technology, material and product testing. The response to the workers' training may be related to the low level of education attained by many of the workers at SMEs interviewed.[17]

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[15] Interviews were conducted in Dhaka in March and May 2010.

[16] The planned TA will include:
(a) support for the financial and legal literacy of women entrepreneurs and associations; (b) enhancement of women entrepreneurs' capacity, productivity, and competitiveness; (c) promotion of networking among women entrepreneurs' associations; and (d) development of a gender-disaggregated database for monitoring and evaluation of the social and gender equality results.

[17] It was found out during the interview that a total of workers at 34 SMEs numbered 1,289 persons. More than half of workers (696) received only primary education.

Regarding connectivity to markets, the KATALYST project and the PRICE project by USAID provide technical assistance for SMEs by taking a value chain approach. The project could cooperate with these other donor activities in cases where target sectors are overlapping. Types of technical assistance could be, for example, in the form of export promotion seminars for the manufacturing sector in urban areas and studies on specific sub-sectors of the manufacturing sector. In conducting such assistance, collaboration with industry specific associations can be pursued. Because these two projects do not offer finance to SMEs, business matching-type workshops among SME and financial institutions will be benefiting both parties. During the period of the survey in Dhaka, the JICA Survey Team had a chance to visit a workshop organized jointly by PRICE project and SMEF, where staff from the two PCBs and one NBFI had chances to interact with representative from SMEs in the leather sector.

6. Analyses on Effective Scheme of JICA Assistance

6.1 Background and rationale of undertaking the JICA assistance

Bangladesh has achieved a high growth rate during recent years. The main engines for the high economic growth are the agriculture sector and the service sector, especially the wholesale and retail trade sector. The economy is characterized with the increasing amount of foreign remittances, which has led the private consumption growth.

In the draft Outline Perspective Plan (OPP) of Bangladesh 2010-2021, the Government of Bangladesh set to raise per capita income to about USD 2,000 by 2021, which means that the country can be classified in the middle income countries. The real GDP growth rate is targeted at 8.0% in 2015 and 10.0% in 2021, respectively, through the industrialization process. The gross investment is expected to increase from 24.2 % of the GDP in FY 2009 to 32.1% in FY 2015 and 37.5% in 2021. In terms of the sectoral share of the GDP, the manufacturing sector is projected to expand from 17.1% in FY 2009 to 30% in FY 2021. Having recognized that the industry sector in Bangladesh has been narrow-based with locational concentration and low share in the total workforce, the OPP pursues SME-based industrialization that will be labor-intensive in nature, decentralized in locational respect, and will be serviced by adequate human resources and technology adoption/adaptation and technology transfer.

Earlier, the Government established the SME Task Force in 2003 in order to draw up a realistic strategy for promoting rapid growth and vigorous competitiveness among SMEs in the interest of accelerating the growth of the economy and the reduction of poverty in the country. SME related policies and strategies consider the smooth and sustainable development of SMEs all over the country as one of the vehicles for accelerating national economic growth, including poverty alleviation, the reduction of unemployment, and the generation of more employment. This is in line with core principles and parameters set by the Poverty Reduction Strategy Paper (PRSP) of 2004 as well as targets set under the Millennium Development Goal (MGD).

Among the number of constraints that enterprises faced in their business environment, access to financing was regarded as one of the major or severe constraints especially for those located in metropolitan areas. The perception of such difficulties among enterprises varies depending on size. For instance, according to the Investment Climate (IC) Survey in 2007, about 73% of large enterprises in metropolitan areas had a loan from a financial institution while only 41% of small and 53% of medium enterprises had a loan. Smaller firms tend to have a loan with a shorter maturity than larger ones.

There are a number of factors explaining market failures. Among them are: stringent collateral requirements; high interest rates due to high yielding Government securities, which make SME financing less attractive; inefficiency in operations represented by the high interest spreads; preference of banks to deal with larger clients due to the perceived higher risks associated with SME lending and higher administrative costs in handling SME loans; and so on. Limited ability of PFIs in assessing longer-term investment projects can be also pointed out.

As part of the concrete measures to support SMEs, refinancing schemes were introduced for promotion of the small enterprise sector in 2004, which has been managed by BB since then. ADB and the World Bank were also supporting the scheme. The SME Foundation was incorporated in 2006 as an independent apex body for SMEs in order to implement the SME policy, strategy and guidelines adopted by the Government. Other donors that support SMEs were, for example, USAID, IFC, DFID, and so on. IFC, together with DFID, has been providing supports to develop the credit information system at BB, enabling to provide Credit Information Bureau (CIB) reports to banks in real time. IFC has been also extending supports to selected banks and NBFIs in order to strengthen the capacity of their SME financing.

Despite the recent efforts of the Government, BB, banks and other concerned organizations in improving SMEs’ access to financing, there are still areas to improve in the light of the policy direction of the Government. Although the amount of loans to SMEs is expected to continue increasing in accordance with the economic growth, it is assumed that most of the loans will be extended to meet needs of short-term working capital in the trade sector while a less amount of medium-and long-term loans will support productive investment of SMEs, particularly in the manufacturing sector.

The proposed project is intended to contribute to filling-in of expected gaps of medium-and long-term loans for investment by providing participating financial institutions with medium-and long-term funds. The stable funds at reasonable costs together with the technical assistance are expected to provide PFIs with incentives to proactively identify prospective SMEs and extend investment loans to them. The project will also support BB and PFIs in terms of implementation of the project scheme and capacity development. Capacity development of PFIs will include loan appraisal and supervision of long-term investment projects and management in issues of maturity mismatches and NPLs. Technical assistance, through employment of consultants, will be provided under the loan program in order to improve loan administration at BB, assist promotion activities of SME financing schemes, develop capacities of PFIs in providing SME loans and coordinate with other relevant programs. It is proposed that a Steering Committee, including representatives from MOF and MOI, be set up and feedbacks of M & E results be planned to be made into arenas for policy formulation such as the National Taskforce for SME Development on a periodical basis. In parallel with the loan program, collaboration will be pursued with technical cooperation projects of other donor agencies and domestic supporting organizations to assist SMEs.

6.2 The approach and the project design

Based on the survey results of the existing and forthcoming refinance schemes, special attention will be paid to the following points:

(1) Enhancement and utilization of PFI capacity to identify prospective SMEs and extend support to them with investment loans;
(2) Creation of a competitive environment among PFIs to improve lending operations;
(3) Equal treatment of sectors, regions, and types of SMEs;
(4) Prompt disbursement against requests for refinance from PFIs;
(5) Avoidance of competition with other refinance schemes;
(6) Pursuance of synergetic and complementary relations with other technical cooperation projects by other donors; and
(7) Employment of consultants to help BB manage the project and provide supports to PFIs.

The following project design describes the possible objectives, the overall goals, the expected outputs and planned activities of the project. In formulating the JICA assistance scheme, it is considered important to keep the approach as simple as possible.

<u>Objective and overall goal of the proposed project</u>
It is considered that the objective of the proposed project will possibly encompass the following factors:
(1) to improve access for SMEs to finance;
(2) to enhance investment of SMEs in the productive equipment and facilities;
(3) to provide medium- and long-term finance through the PFIs;
(4) to strengthen the capacity of the PFIs;

(5) to strengthen the capacity of BB; and
(6) to contribute to the improvement of the productivity of SMEs in Bangladesh.

Outputs

Output 1: Stable medium-and long-term loans at reasonable cost are provided to financial intermediaries for on-lending to prospective SMEs.

Output 2: Project management of medium-and long-term loans at BB will be improved by promptly responding to the requirements of SMEs.

Output 3: The capacity of PFIs in extending financial supports to SMEs will be enhanced.

Output 4: The monitoring and evaluation function of the Project Implementation Unit (PIU) at BB will be enhanced in order to provide feedback on lessons learnt for policy formulation for the promotion of SMEs.

Project activities

Activity 1: Sub-loan component

1-1: Undertake all the administrative procedures with MOF and JICA to receive disbursement of loans
1-2: Review and set-up the accreditation criteria of PFIs
1-3: Select PFIs and conclude participating agreements with accredited PFIs
1-4: Provide medium-and long-term loans to SMEs through accredited PFIs
1-5: Ensure a principal portion of sub-loans to be revolved for the promotion of SMEs under the same terms and conditions

Activity 2: Project management at BB

2-1: Undertake internal procedures to establish the Project Implementation Unit (PIU)
2-2: Undertake internal procedures to employ consultants
2-3: Set up project management systems including operating guidelines, selection of PFIs, conclusion of participation agreements with accredited PFIs, process and disbursement of applications from PFIs, management of product funds and revolving funds.
2-4: Cause to organize periodical Steering Committee meetings to review the conditions of project implementation and formulate relevant necessary measures and policies for improvement of implementation
2-5: Establish a coordination mechanism with other organizations (donors and domestic supporting organizations) to promote SME loan products to SMEs
2-6: Establish a coordination mechanism with other organizations to facilitate the identification of prospective SMEs that need investment in productive equipment and facilities and or technical assistance
2-7: Plan and organize capacity development programs for BB, including workshops, seminars, study tours in and outside the country
2-8: Organize workshops and seminars to promote women entrepreneurs
2-9: Promote the project to increase competition among PFIs
2-10: Ensure compliance with domestic and JICA environmental and social consideration
2-11: Prepare periodical reporting to the Government and JICA

Activity 3: Capacity development of PFIs

3-1: Plan and organize capacity development programs for PFIs for loan appraisal and supervision of long-term investment projects
3-2: Plan and organize capacity development programs for PFIs for management in terms of issues such as maturity mismatches and NPLs
3-3: Review and improve capacity development programs

Activity 4: Monitoring and evaluation

4-1: Review existing monitoring and evaluation systems at SMESPD

4-2: Make necessary adjustments and improvements over the existing system
4-3: Conduct periodical monitoring and evaluation of the project implementation in order to feed-back results into future policy formulation
4-4: Conduct an impact study of the project and feed back results into future policy formulation

6.3 Proposed Implementing Arrangements

(1) Executing agency and implementing agency
The Bank and Financial Institution Division, a newly created division under the Ministry of Finance (MOF), will play the role of executing agency on behalf of the Government of Bangladesh (GOB). It bears the prime responsibility of receiving and repaying Japanese ODA loans from and to JICA and supervision of the project in the light of the development policy of the Government. On the other hand, Bangladesh Bank, an implementing agency, will act as the agent responsible for achievement of the project objective under the administration agreement concluded between MOF and BB. Figure 6-1 shows the implementation arrangement of the proposed project.

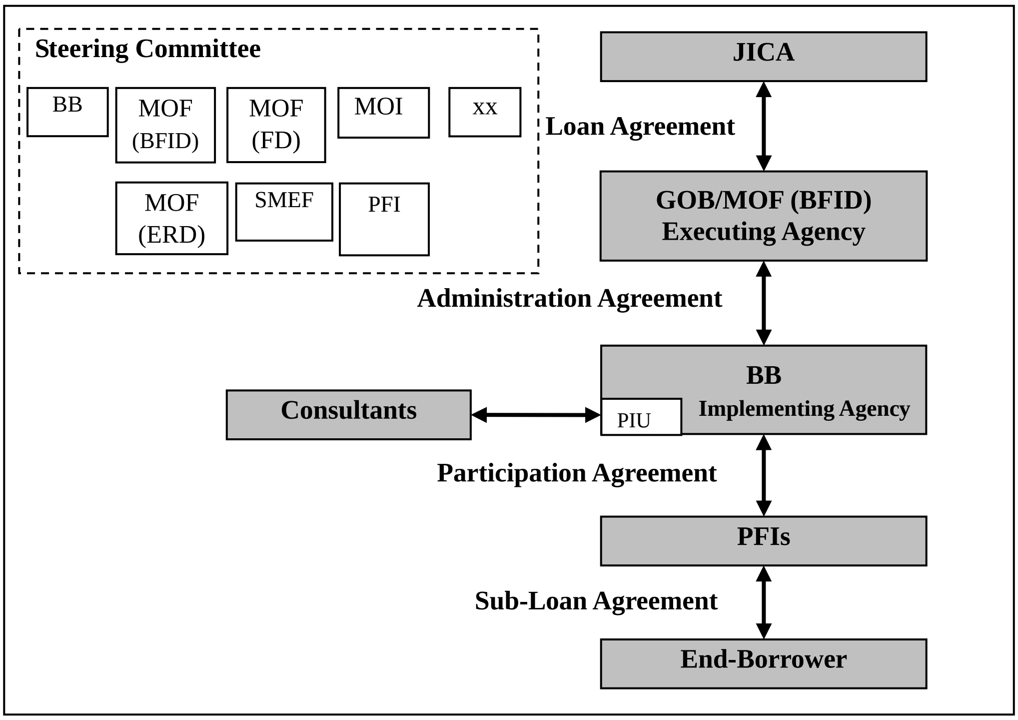

Figure 6-1: Implementing arrangements with agreements to be concluded among concerned parties

(2) Establishment of the Project Implementation Unit (PIU)
For the purpose of the smooth implementation of the project, a Project Implementation Unit (PIU) will be established at BB with a full-time Project Director and staff members who will specifically handle all relevant tasks related to the project, separately from the existing administrative structure. In accordance with the operating guidelines of the project, the PIU will perform, among others, the following tasks:

1) Preparation for the formulation and implementation of the overall project plan and the annual operation plan and budgets,
2) Organizational set-up and capacity building,
3) Preparation of operating instructions, participation agreements, sub-loan agreements, etc.

4) Accreditation of Participating Financial Institutions (PFIs) and yearly review of their performance,
5) Management of the project funds and revolving funds,
6) Management and supervision of sub-loans,
7) Planning and organization or causing to organize workshops and seminars in order to promote the project,
8) Planning and organization or causing the organization of workshops for the capacity development of PFIs in SME operations,
9) Employment and supervision of consultants, and
10) Monitoring and evaluation of the project, and reporting to higher authorities and JICA.

(3) Establishment of a Steering Committee
For the smooth implementation of the project within the framework of the SME promotion policy of the Government, a Steering Committee will be established at ministry level. The Committee discusses and makes decisions on policy issues for the project such as the operating guidelines, the accreditation criteria of PFIs and their periodical review, the establishment and amendment of terms and conditions of the sub loans, feedbacks of lessons learned from the practical experience of the project implementation into the policy formulation of the National Taskforce for Development of SME[1] and so on.

Proposed members of the Committee: BB, Finance Division (FD) and Economic Relations Division (ERD) of MOF, Ministry of Industries (MOI), SME Foundation, a PFI nominated by BB[2], etc.
- Chairman: Bank and Financial Institution Division (BFID), MOF
- Agenda: Coordination of policy issues relevant to the project implementation and management

(4) Relending to Participating Financial Institutions (PFIs)
Under the proposed scheme, a subsidiary loan agreement (a participation agreement) will be concluded between the implementing agency (BB) and Participating Financial Institutions that have passed pre-set accreditation criteria.

6.4 Loan scheme and specific features of the proposed project

6.4.1 Target beneficiaries and other specific features of the project

(1) Definition of SME
Target beneficiaries of the project will be SMEs as defined by BB. BB, MOI, BOI and BBS agreed to adopt uniform definitions of SMEs in 2008. This definition is likely to change under the new Industrial Policy 2010. The JICA Survey Team is of the opinion that the proposed project uses the existing uniform definition that the four concerned organizations unanimously agreed with in 2008 for the time being. Once the new definition has been finalized and agreed by concerned parties, a steering committee will be held to decide the definition appropriate for the project. The appropriate definition for the project will be discussed in consideration of the range of the target beneficiaries and sub-loan sizes proposed by the JICA Survey Team.

Both SMESDP Phase 1 and IDA assisted refinance schemes targeted at enterprises that have fixed assets not exceeding Tk 10.0 million, which are classified into small enterprises under the current definition. SMESDP Phase 2 will expand the eligibility criteria up to the size of enterprises that have fixed assets not exceeding Tk 200 million (excluding land and buildings)

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1 Reconstitution of the National Taskforce for Development of SME is described in Chapter 3.3.
2 Being an apex body for SMEs, SMEF is expected to participate in the steering committee on behalf of SMEs while a PFI is considered to represents the financial sector.

or a workforce not exceeding 150 employees. Under the current definition of BB, these criteria refer to the upper limit of medium enterprises in the manufacturing sector. There are no specific sectors being targeted and SMEs in all sectors will be eligible for refinancing schemes.

(2) Sector/geographical location

Eligible SMEs belong to either of the manufacturing, trade or services sectors. SMEs in different sectors and of different natures (such as gender) will be equally treated with regard to the terms and conditions of loans so far as they satisfy pre-set eligibility criteria. The idea of equal treatment is based on the lessons learnt from the existing refinance schemes as described in Chapter 4.6.4. Non-eligible types of industries for finance shall be defined under the project.

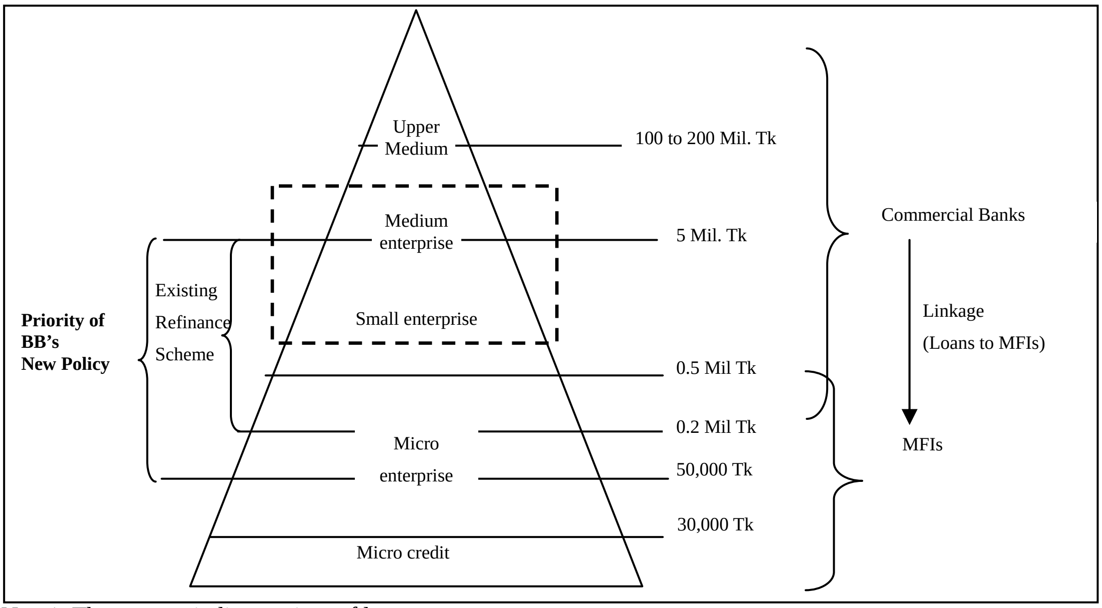
There have been no conditions set on the geographical location of business under the ADB's SMESDP Phase 1 and IDA projects. However, having found a regional disproportion of beneficiaries under Phase 1, the SMESDP Phase 2 project aims to enhance the growth of SMEs, especially in rural and nonurban areas and excludes SMEs located inside the metropolitan areas of Dhaka and Chittagong from being eligible beneficiaries.

On the other hand, the proposed JICA assisted project places higher priority on enhancement of the investment by SMEs in productive equipment and facilities in order to contribute to the improvement of the productivity of SMEs. The proposed project includes the metropolitan areas of Dhaka and Chittagong.

(3) Size of sub-loans

The size of sub-loans could range from Tk 0.5 million to Tk 50.0 million.

The dotted line in the following Figure shows the range of main target SMEs in terms of their loan absorption capacities in comparison with existing refinance schemes.



Note1: The amount indicates sizes of loan amounts.
Note 2: The main target beneficiaries are shown in the dotted red line.

Figure 6-2: Main target beneficiaries

The on-going refinance schemes of BB set a range of sub-loan sizes from Tk 0.2 million to Tk 5.0 million. The schemes target at small enterprises having fixed assets not exceeding Tk 10.0 million. The forthcoming ADB-assisted SMESDP 2 will increase its upper limit of sub-loans from Tk 5.0 million to Tk. 7.0 million. Although the eligibility criteria of enterprises cover both small and medium enterprises,[3] it is considered that the target of Phase II is still small enterprises.[4] On the other hand, under the proposed JICA project, the project will accommodate the borrowing needs of SMEs ranging from Tk 0.5 million up to Tk 50.0 million and use of the project is limited primarily to investment purposes, except for initial working capital. There are a number of reasons for this increase: 1) the proposed project plans to accommodate investment needs of both small and medium enterprises (including those scaling up from the smaller to the higher level), particularly in the amount from Tk 3 million to at least Tk 10 million based on the observation that SMEs that are in needs of this range of investment have been underserved; 2) sub-loans lower than Tk 0.5 million are the segment that MFIs are able to extend supports to; 3) the draft Industrial Plan proposed to increase the upper limit of the fixed investment for SMEs. Thus, it is proposed to increase the upper limit of sub-loans in order to accommodate increasing needs of fixed investment and support for the graduation of micro-enterprises into small and small enterprises into medium is planned. This is subject to further study and discussions.

(4) Interest rate

As for the relending interest rate of loans to PFIs from BB, on-going schemes use Bank rate (5.0% p.a. as in June 2010). For the on-lending interest rate of sub-loans to SMEs by PFIs, each PFI will determine a rate within the reasonable range.

As the JICA loan bears far lower concessionary rate, there could be possible room to decrease the level of the relending and on-lending interest rates. A decrease in the relending interest rate from BB to PFIs will possibly lead to an decrease in the onlending interest rate from PFIs to SMEs, but it is also considered to have some distorting effects in the market where all other refinance schemes use the Bank rate for relending. This is still subject to discussion. It is also important to consider possible ways to utilize interest spreads between the interest rate of JICA ODA Loan and the interest rate to BB.

For reference, the following shows the overall interest rates at different levels under the existing refinance scheme.

[3] The Loan Agreement of SMESPD Phase II stipulates qualified enterprises as those having fixed assets not exceeding Tk 200.0 million (excluding land and building) or a workforce not exceeding 150 employees

[4] While it was difficult to precisely quantify the extent of unmet demand for small enterprise loans, ADB identified a significant body of evidence that many viable small entrepreneurs, particularly those below Tk 5 million, could not obtain the amount of credit that they required from the formal financial sector (ADB 2009: P.45).

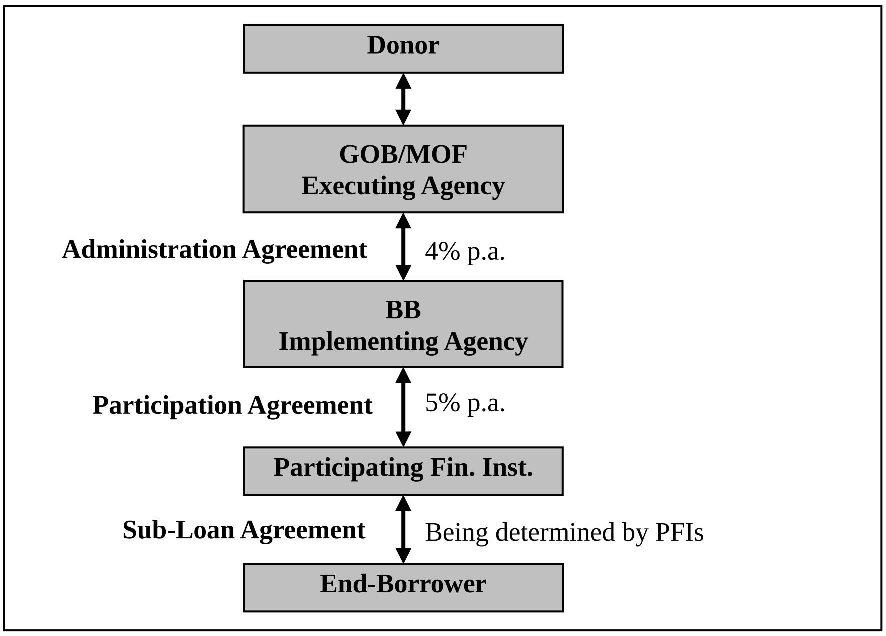


Figure 6-3: Interest rates at different levels under the existing refinance scheme

(5) Geographic distribution
Throughout the country

(6) Administration of the special account and revolving funds
1) Special Account to be opened
A special account (referred to as the "impress account" in the ADB loan) will be opened under the name of the Executing Agency at BB to receive disbursement from JICA under the disbursement method called "Special Account". The disbursed amount will be transferred to the Special Account to be managed by BB and disbursement to PFIs will be directed from this Special Account.

2) Funds to be credited to the Revolving Fund Account:
The principal portion of the repayment from PFIs to BB will be credited to the Revolving Fund Account, which will be opened under the name of the Executing Agency.

3) Disbursement of the Funds from the Revolving Fund Account
The Revolving Fund Account administrates the second and succeeding generations of sub-loans. The following figure describes the flows of initial disbursement and revolved funds.

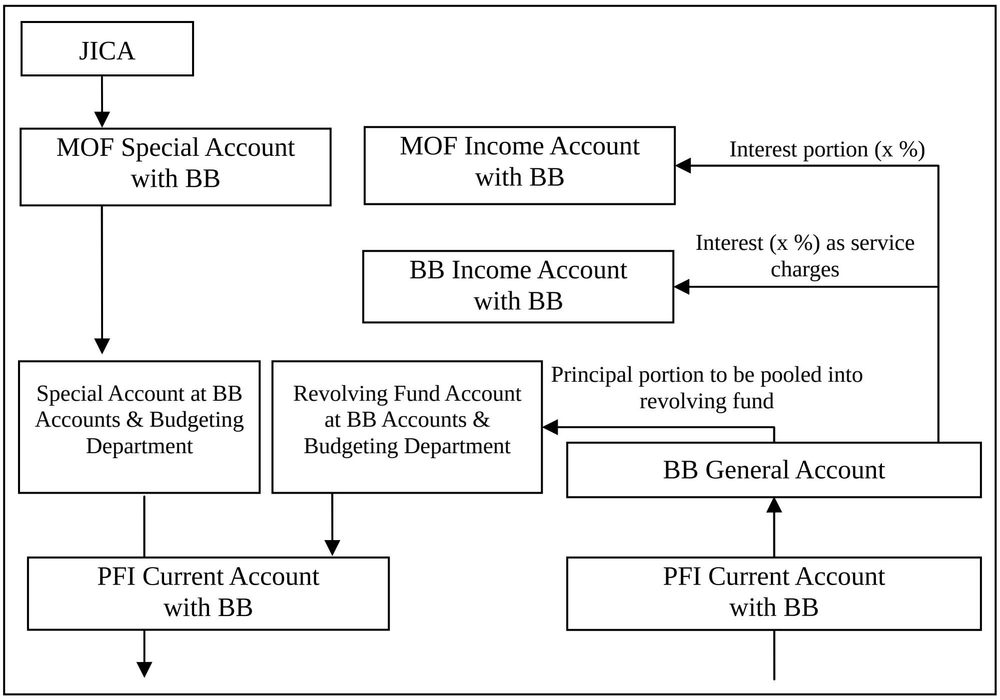


Figure 6-4: Fund flow under the proposed project

(7) Preferential measures

Preferential measures have not been proposed under the proposed project. During the survey period, it was suggested from the Bangladeshi side that it would be worth studying possibilities of applying preferential conditions of sub-loans for a start-up SME. It was also suggested that it would be important to give special considerations to women entrepreneurs even for a limited period of time during the project period. These issues are subject to further study and discussions.

6.4.2 Subsidiary agreement (participation agreement) between BB and PFIs

(1) Selection criteria

1) Legality

Scheduled Banks and Non-Bank Financial Institutions duly licensed, approved and supervised by BB are eligible for PFIs.

2) Operation Experience

Financial institutions must have the experience of business operation in banking and/or finance at a minimum three full years with audited records. In case the financial institutions are of subsidiaries to other financial entities in Bangladesh or in foreign countries, the experiences of the parent companies are allowed to be counted.

3) Capital

(i) Financial institutions must fulfill the minimum capital requirement as regulated by BB in its latest audited financial statements.

(ii) Financial institutions failing to meet the risk weighted capital adequacy ratio as regulated by BB shall not be eligible for PFIs.

4) Earnings

Financial institutions must have the records of the profitable financial closing for two consecutive fiscal years including the latest one.

5) Non-Performing Loans

Financial institutions having NPL ratio exceeding 10% for the latest fiscal year shall not qualify for PFIs.

6) Problem Banks

Financial institutions that are classified as the problem bank or the early warning bank shall not qualify for PFIs.

(2) Accreditation Process

Accreditation procedures shall be established and implemented in selecting PFIs for the project considering the following:

1) Eligible financial institutions
2) Application procedures
3) Monitoring and review of PFI compliance with accreditation criteria

(3) Participation agreement

Participation agreements (or subsidiary agreements) are to be signed between BB and accredited PFIs.

(4) Loss of Eligibility

The performance of accredited PFIs will be annually reviewed and PFIs that are failing to meet the criteria will be addressed to submit remedial plans for examination by the Implementing Agency and approval of Steering Committee. The Implementing Agency and Steering Committee may agree to allow those banks for continuation of PFI status setting a time limit if the plans submitted are sufficient to endorse that the non-compliance shall be resolved within a reasonable time limit.

(5) Entry and Exit

At the time of annual review of PFIs, applications for new entry and/or exit shall be reviewed and be approved.

(6) Tentative List of Candidates for PFIs

The JICA Survey team collected financial information from the financial institutions. The numbers of information collected are; 4 out of 4 from SCBs, 3 out of 4 SBs, 27 out of 30 PCBs, 2 out of 9 FBs, and 13 out of 29 NBFIs, based on which financial institutions were analyzed in their eligibility with the above criteria. Following is the list of the financial institutions that are failing to meet the criteria described above. There may exist and emerge other institutions whose information were not made available but are failing to qualify.

Table 6-1: List of Banks Failing to Qualify

Regulatory Item	Norm	Banks Failing to Qualify
Minimum Capital	Tk 4 billion in net worth out of which Tk 2 billion in paid-up capital (*1) (Tk 0.5 billion in net worth for NBFIs). Deadline for compliance: August 2011 (NBFIS: December 2010)	A large number of institutions having shortfalls including; 1 SCBs, 3 SBs, 15 PCBs, and 3 NBFIs.
Capital Adequacy	10% for the years prior to Jan. 1, 2010 with a temporary relaxation till July 2011 for transition to BASEL-II.	Financial institutions of negative net worth are found at; Rupali Bank (SCB), Bangladesh Krishi Bank (SB), RAKUB Bank (SB), and ICB Islamic Bank (PCB).
Non-Performing Loans	No regulatory norm is established but affects the CAMELS rating by BB	Financial institutions whose NPLs exceeding 10% are found at; Sonali Bank (SCB), Agrani Bank (SCB), Rupali Bank (SCB), Bangladesh Krishi Bank (SB), RAKUB Bank (SB), ICB Islamic Bank (PCB), IPDC (NBFI), and Fareast Finance (NBFI).

Regulatory Item	Norm	Banks Failing to Qualify
Earning Capability	No regulation	Banks recording negative net profits are found at; Bangladesh Krishi Bank (SB), RAKUB Bank (SB), ICB Islamic Bank (PCB)
Problem Bank or Early Warning System	Banks are classified by BB based on the CAMELS rating method.	As of FY 2009, BB releases in its Annual Report 2008-09 that two banks are classified as the problem banks and seven banks are classified as the banks under Early Warning System. The names of the banks are not disclosed.

Note: Previous regulation for minimum capital was for the amount of Tk 2.0 billion in the paid-up capital plus statutory reserve. Banks with shortfalls had to meet at least 50% of the shortfall by June 2008 and the rest by June 2009.

(7) Financing methods
The proposed project will adopt a mixture of refinancing and pre-financing methods depending on the amount of sub-loans as follows:

Refinancing method for sub-loans smaller than Tk 7.0 million

Pre-financing method for sub-loans equal or above Tk 7.0 million (proposed as an option to be chosen by PFIs)

It should be noted that the pre-financing method does not mean that BB will make a certain amount of deposits in a PFI account. Disbursement under the pre-financing method will be made on a loan-by-loan basis. The initial cut-off amount of Tk 7.0 million used for differentiating financing methods (refinancing and pre-financing) is proposed because the ADB-assisted SMESPD 2 offers sub-loans up to Tk 7.0 million under the refinancing method. This initial cut-off amount, however, will be reviewed at the Steering Committee after examining convenience in usage.

The cut-off date by which a request for refinance could be retrospectively made will be determined later.

(8) Repayment Period
The repayment period of the subsidiary loan will be synchronized with the maturity period of sub-loans to end-borrowers. It is intended to avoid leaving any unused funds in the hands of PFIs.

(9) Currency
Bangladesh Taka

(10) Credit Risk and Exchange Risk
Credit risk of PFIs to be born by BB
The Government of Bangladesh shall bear the exchange risk in converting the ODA Loan received into Taka.

(11) Rate of Interest
On-going refinancing schemes use Bank rate (5.0% p.a. as in June 2010) to relend to PFIs. The level of the relending interest rate needs to be further studied.

(12) Collateral
Subject to the prevailing rules and regulations of BB. Under the existing refinancing schemes, in the case of a PFI fails to repay any installment of loans as per the repayment schedule, BB

will realize the installment amount with interest by debiting the current account of the concerned PFI maintained with BB.

6.4.3 Sub-loan agreement between PFIs and end-users

(1) Sub-Loans from PFIs to End-Borrowers
A sub-loan agreement is to be signed between PFI and end-borrower.

(2) Eligible items for finance
1) Fixed assets (including machinery, equipment, factory buildings and related civil works), technical know-how, consulting services and training. Purchase of land or land use rights and payment of tax and import duties are not eligible for financing.
2) Initial working capital, which can be annually renewable up to five years based on actual results of sales and production.
The working capital loan will be sanctioned so far as effective use of the investment loan can be expected. Mere working capital loans will not be extended.
3) Leasing of industrial and business equipment

The JICA Survey Team understands that many SMEs are in needs of short-term working capital financing. However, so far as the working capital loans are concerned, banks and NBFIs are able to support SMEs within their usual business activities. For the proposed project to address to the issue for which the market fails to clear, eligible items for finance are basically limited to procurement of fixed assets excluding land, and technologies, etc. However, to the extent that the investment in the fixed assets, etc. is made more effective, it is proposed that the initial working capital be financed under the project. In order to limit use of the working capital, the duration of which the initial working capital can be renewable is set at five years.

(3) Repayment Period
Medium/long term loan: From two (2) year to eight (8) years[5] including a grace period of one (1) year, except for the initial working capital associated with the investment that needs to be repaid in one year but is renewable up to 5 years based on actual results of sales and production.

(4) Financing Structure
The total project cost shall be financed by the three parties concerned: the end-borrower, the PFI and the JICA Loan, as follows;
1) End-borrower: at least 10 %
2) PFI: at least 15%
3) JICA Loan: up to 75 %
The end-borrower's contribution may include contribution in kind.

The JICA Survey Team understands that both SMESDP Phase 1 and IDA did not set specific financing requirements for PFIs and project owners. However, SMESDP Phase 2 requests that

[5] Considering the fact that banks are able to mobilize deposits up to 2 years in a relatively easy manner, it is proposed the tenor of sub-loans are set at two years and longer for the JICA project. The maximum repayment period may be set at 8 years by referring to the buy-back period of the shares for the sponsors of the project under the Equity and Entrepreneurship Fund (EEF). EEF was introduced in FY 2000-2001 to encourage investors to invest in the risky but otherwise promising two sectors, viz the software industry and the food processing and agro-based industry. The Government had authorized BB to manage the EEF, which in turn transferred its operation to the Investment Corporation of Bangladesh (ICB) under a sub-agency agreement from 2009. As of June 2009, Tk 6.3 Billion has been released to the fund by the Government out of a total budgetary allocation of Tk 15.0 Billion, of which Tk 5.2 Billion was actually invested. EEF supported 205 agro-processing projects and 32 IT related projects as of March 2010. The sponsors of the project/company are supposed to buy-back the shares issued in the name of the Government within a period of 8 years. So far, 14 EEF supported companies used share buy-back facilities as of March 2010.

PFIs bear 15% of the project costs and Project Owners bear 10%. While the inclusion of PFIs' funds may provide PFIs with a better incentive to select end-users and monitor their behavior, it will certainly increase the weighted average of the cost of funds, which is likely to result in higher lending rates of sub-loans to SMEs, and also to complicate the procedures. However, the JICA Survey Team is of the opinion that the mobilization of medium-and long-term funds for the PFI portion of the investment loans will help prolong the time horizon of SME loans by allowing them commit to secure medium-and long-term funds. Accordingly, it is proposed that the financing structure be applied to the proposed project, which is same as the one applied to SMESDP Phase 2.

(5) Rate of Interest on Sub-loan
To be determined by respective PFIs within a reasonable range

(6) Currency of Sub-loan
Bangladesh Taka

(7) Credit Risk
Credit risk of end-borrowers to be born by PFIs
Exchange Risk will be born by the GOB

(8) Collateral
Subject to the rules and regulations prevailing in Bangladesh

(9) Environmental Clearance
Subject to the rules and regulations prevailing in Bangladesh
In addition, JICA's guidelines for confirmation of environmental and social considerations will be applied.

6.5 Project cost

The loan is supposed to be based on the gaps expected between demand and supply of loans, but it is difficult to estimate such gaps because they are greatly affected by the pre-conditions, of which relevant data is not always available. Although it is necessary to receive comments from the Bangladeshi side on the appropriate size of the loan for implementation of the project and make a further study on it, a loan could range possibly from USD 30 million to USD 50 million based on the analysis of Chapter 4.7. The following table shows the estimated project cost when the amount of JICA ODA sub-loan portion is USD30 million. In this case, the total project cost is estimated at USD 43 million including portions of PFIs and SMEs. The cost breakdown in this case is shows as in the table below:

Table 6-2: Estimated project cost (tentative)

USD million

Item	Amount
1. Sub-projects	40.0
JICA ODA sub-loans	30.0
PFIs' sub-loans	6.0
SME contributions	4.0
2. Consultant (JICA ODA Loan)	3.0
3. Total Project Cost (1+2)	43.0
Out of which: ODA Loan portion	(33.0)

The cost of consultant employment, including software development and capacity building, is estimated at 10% of the portion of the JICA ODA sub-loan although this requires further elaboration. Part of the project cost that BB is supposed to bear under the proposed project need to be clarified later.

The table below shows a tentative financing plan of the project in the above case. The project implementation period is tentatively set at 5 years and a pattern of the expected disbursement is presented in the table as an example. This is also subject to a further study and discussions.

Table 6-3: Annual financing plan of the project (tentative)

USD million

	Year 1	Year 2	Year 3	Year 4	Year 5	Total
1. Sub-loan portion	0.0	8.0	13.3	14.7	4.0	40.0
JICA ODA sub-loan	0.0	6.0	10.0	11.0	3.0	30.0
PFIs' sub-loans	0.0	1.2	2.0	2.2	0.6	6.0
SME contributions	0.0	0.8	1.3	1.5	0.4	4.0
2. Consultant (JICA ODA Loan)	0.5	1.2	0.7	0.5	0.1	3.0
3. Total (1+2)	0.5	9.2	14.0	15.2	4.1	43.0

6.6 Possible technical assistance and study to be provided

(1) Consulting services under the proposed loan project

Based on lessons learnt from the on-going refinance schemes described in the previous chapters (Chapters 4 and 5), it is planned under the JICA project that the project will quickly respond to SME need for a loan by improving management and control of the project funds/revolving funds and also to monitor and evaluate the effectiveness and impact of the project. For this purpose, it is important and necessary that consultants are employed under the loan project. Development of management software for SME financing programs and capacity development of BB and PFIs including study tours are also planned under the consulting services.

It is proposed that BB employs a team of consultants to assist in implementation of the project. The terms of reference will, among others, include the following tasks:

1) Assistance to BB in terms of management and control of the project funds/revolving funds, including software development for the administration of sub-loans (aiming to achieve a prompt response to requests for refinance from PFIs like EDF)
2) Capacity building of the implementing agency (training courses, workshops, study tours, etc.)
3) Capacity building of PFIs (training courses on loan appraisal and supervision of long-term investment projects, strengthening of management in terms of issues such as maturity mismatches and NPLs)
4) Monitoring and evaluation (including impact studies on topics such as the creation of employment and contribution to economic growth)
5) Study on improvement of access to finance based on the experiences gained through implementation of the project
6) Promotion in order to broaden and deepen understanding of the project objective and scope among parties concerned and also to increase competition among PFIs by providing information on PFIs to potential SME borrowers
7) Organize workshops and seminars to promote women entrepreneurs

8) Coordination with other programs and supporting organizations.
9) Compliance with domestic and JICA environmental and social considerations

Employment of consultants out of the proceeds of the JICA ODA loan will be done in accordance with the Guidelines for the Employment of Consultants under Japanese ODA Loans prepared by Loan Procurement Policy and Supervision Division, Financing Facilitation and Procurement Supervision Department of JICA in March 2009.

(2) Possible technical cooperation in parallel with the loan assistance

In parallel with the loan scheme, possibilities and options to extend technical cooperation to concerned organizations in Bangladesh could be considered. The following may be a candidate for possible technical cooperation projects under the JICA assistance: however, this is subject to further discussion and elaboration.

Capacity development of relevant agencies to support SMEs under the technical cooperation project in such fields as management, preparation of financial statements, financial management, investment planning and evaluation, production management to increase added values through improvement quality and design, advice on technology to be applied and marketing assistance.

In the terms of the supports to SMEs, a number of criteria could be applied to screen SMEs to be supported by relevant agencies. For example, the following criteria can be applied:

i) SMEs as defined by BB
ii) SMEs that intend to invest in equipment and facilities in the next two years with loans from financial institutions, but are expected to face difficulties in accessing finance
iii) SMEs that are willing to improve production management, aiming to improve the quality of products, reduce production costs, document financial records and information, etc.
iv) Women entrepreneurs and SMEs that require special support such as those proactively employing disabled workers.

(3) Possible study to be provided

1) Study on other possible ways to improve credit access
2) Sub-sector study of the manufacturing sector
3) Study on the credit guarantee schemes (Annex 8 for credit guarantee scheme)

6.7 Collaboration with other donor agencies

There are a number of donor agencies supporting SMEs in various fields. They are, among others, IFC-BICF, IFC-SEDF, IFC-DFID, KATALYST project, USAID's PRICE and EC's INSPIRED project. The following are the possible areas where collaboration might take place with these projects.

Project	Possible areas of collaboration
IFC-BICF	Sharing information on the current conditions of SMEs, support for development of business service providers
IFC-SEDF	Support for development of capacity of SMESDP in their monitoring and evaluation of sub-projects, support for development of capacity of banks and NBFIs
IFC-DFID	Utilization of on-line credit information system
KATALYST	Identification of prospective end-users

Project	Possible areas of collaboration
USAID-PRICE	Identification of prospective end-users, information sharing with lead firms in the target industries
EC INSPIRED Project	Support for business service providers

Pursuing complementary relationships with other technical cooperation projects from other donors will help identify prospective potential borrowers for the JICA loan project.

6.8 Social and Environmental Consideration

6.8.1 Environmental Assessment Procedures in Bangladesh

Major Bangladesh domestic strategies, policies, laws and rules related to the environment are shown below;

1) Environmental Policy, 1992,
2) Environmental Action Plan, 1992,
3) Environmental Conservation Act, 1995,
4) Environmental Conservation Rules, 1997,
5) National Conservation Strategy (NCS), 1992,
6) National Environmental Management Action Plan “NEMAP”, 1995, and
7) Environmental Court Act, 2000.

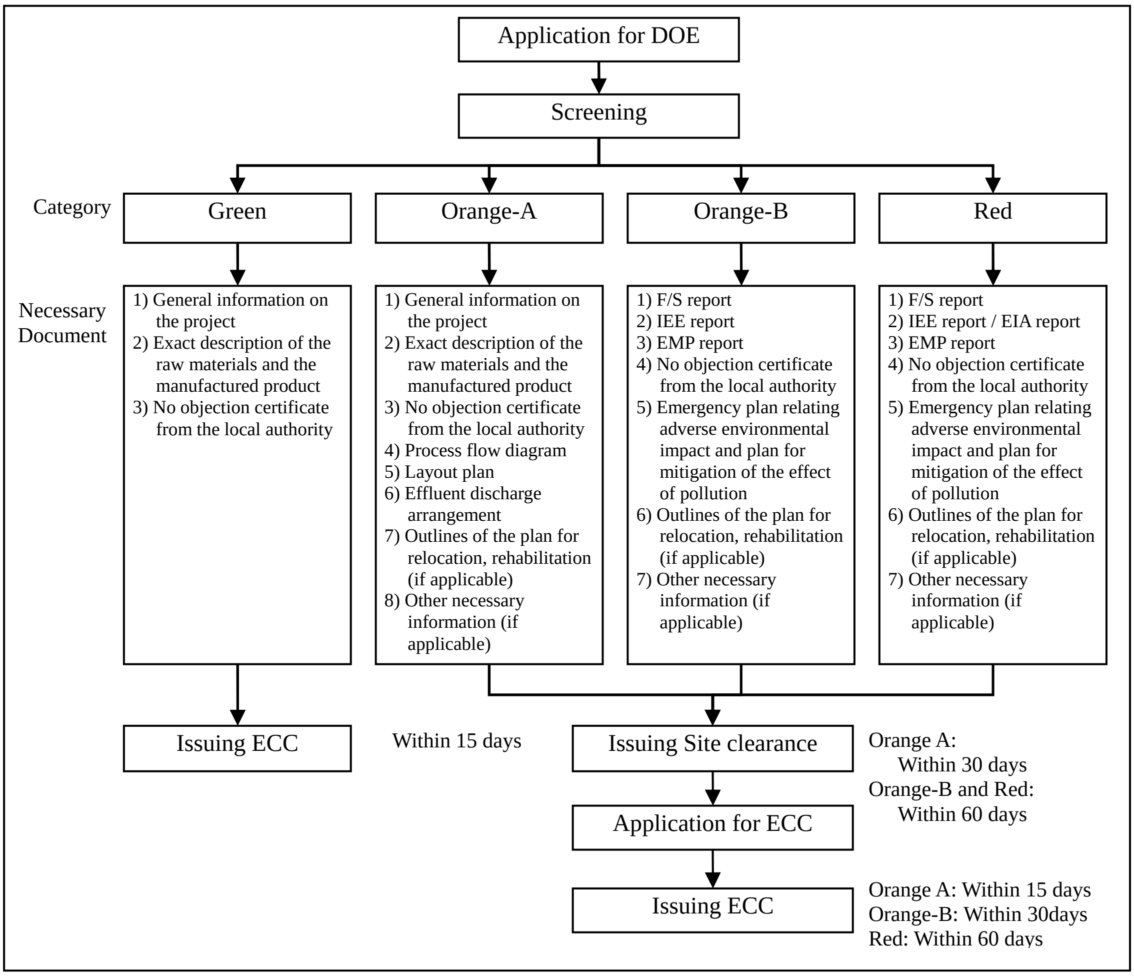
The procedures and requirements for Environmental Impact Assessment (EIA) are stipulated in the Environmental Conservation Rules under the Environmental Conservation Act, 1995. As detailed EIA guidelines for procedures, investigation content and assessment processes, were required, EIA Guidelines for Industries was issued by the DOE in 1997. In acquiring the Environmental Clearance Certificate (ECC) which is the environmental approval necessary for the location and implementation of industries and enterprises, the target industries and enterprises shall be classified into four categories (Green, Orange-A, Orange-B, Red) (Details are shown in Annex-9).

6.8.2 Flow of procedures

In the case of Projects which are subject to EIA through the above mentioned screening, the following procedures to acquire the Environmental Clearance Certificate (ECC) should be taken for each category

Regarding industries or enterprises categorized as “Green”, the necessary procedure is only to acquire ECC. In the case of other categories, Site Clearance is needed in principle before the acquirement of ECC. Only when the Director General of the Department of the Environment gives special permission, the industry or enterprise can apply for ECC directly without the procedure of Site Clearance. The period of validity of an ECC shall be three years for Green category projects and one year for other category projects.

Figure 6-5 show a flow chart of the procedures to acquire ECC.



Source: JBIC Bangladesh Environmental Profile, Bangladesh Ministry of Environment and Forest, Environment Conservation Rules, 1997

Figure 6-5: Flow chart of the ECC acquirement process

6.8.2.1 Organization for giving approvals

The Director or Deputy Director Divisional Office in a division where the industry or enterprise is located will accept the application form for ECC and review it.

6.8.2.2 Restrictions by environmental category

In relation to ECC procedure, the Environment Conservation Rules stipulate restrictions by each environmental category as follows:

Green Category:

(a) Units of all kinds of cottage industries other than those listed in the Green category shall remain outside the purview of the Environmental Clearance Certificate (Unit of cottage industry means all industrial units producing goods or services in which family members are engaged in full-time or part-time labor and where the capital investment does not exceed Tk. 500,000.

(b) No industrial unit listed in the Green category shall be located in any residential area.

(c) Industrial units shall preferably be located in areas declared as industrial zones or in areas where there is a concentration of industries or in vacant areas.

(d) Industrial Units likely to produce sound, smoke, odor beyond a permissible limit shall not be acceptable in commercial areas.

Orange Category:
(a) No industrial unit included in the Orange Category A and B lists shall be located in any residential area.
(b) Industrial units shall preferably be located in areas declared as industrial zones or in areas where there is a concentration of industries or in vacant areas.
(c) Industrial Units likely to produce sound, smoke, odor beyond a permissible limit shall not be acceptable in commercial areas.

Red Category:
(a) No industrial unit included in the Red Category list shall be located in any residential area.
(b) Industrial units shall preferably be located in areas declared as industrial zones or in areas where there is a concentration of industries or in vacant areas.
(c) Industrial Units likely to produce sound, smoke, odor beyond a permissible limit shall not be acceptable in commercial areas.
(d) After obtaining location clearance on the basis of the Initial Environment Examination (IEE) Report, the EIA Report in accordance with the approved terms of reference along with the design of ETP and its time schedule shall be submitted within the approved time limit.

6.8.2.3 JICA Environmental Guidelines

Under the proposed project, the former JBIC Environmental Guidelines (Japan Bank for International Cooperation Guidelines for Confirmation of Environmental and Social Considerations, April 2002) should be applied.

According to the former JBIC Environmental Guidelines, the project proponents are responsible for the environmental and social considerations for the project. JICA confirms such considerations in light of the Guidelines. JICA also encourages project proponents to seek funding from JICA in order to undertake the appropriate environmental and social considerations in accordance with the nature of the project.

In concrete terms, the following procedures are taken by JICA under the former JBIC Guidelines:
1) Screening: to classify Category A, B, C, or FI
2) Environmental Review: to review environmental and social considerations when making a decision on funding, to confirm that the requirements are duly satisfied
3) Monitoring: to conduct monitoring and follow-up after the decision has been made on funding.

The proposed project is designed to provide financing to financial intermediaries. Sub-projects can not be specified prior to JICA approval for financing, as they may have environmental impacts. Therefore, the project will be classified as Category FI under the former JBIC Environmental Guidelines.

For a project classified as Category FI, JICA checks through the financial institutions to see whether the appropriate environmental and social considerations as stated in the Guidelines are ensured for sub-projects.

6.8.2.4 Consistency with the former JBIC Environmental Guidelines

Consistency with the former JBIC Environmental Guidelines is shown in Table 6-4.

Table 6-4: comparison between Bangladesh and he former JBIC Environmental Guideline

JICA (former JBIC) Guideline (2002)		Bangladesh Category
1. Sensitive Sectors		
(1)	Mining	
(2)	Oil and natural gas development	Red
(3)	Oil and gas pipelines	Red
(4)	Iron and steel (projects that include large furnaces)	Red
(5)	Non-ferrous metals smelting and refining	Red other than stipulated in Orange-B
(6)	Petrochemicals (manufacture of raw materials; including complexes)	Red
(7)	Petroleum refining	Red
(8)	Oil, gas and chemical terminals	Not stipulated, but possibly Red
(9)	Paper and pulp	Red
(10)	Manufacture and transport of toxic or poisonous substances regulated by international treaties, etc	Not stipulated, but possibly Orange-B or Red
(11)	Thermal power	Red
(12)	Hydropower, dams and reservoirs	Red
(13)	Power transmission and distribution lines involving large-scale involuntary resettlement, large-scale logging or submarine electrical cables	Red
(14)	Roads, railways and bridges	- road/bridges: Orange-B or Red, depending on kinds or length - railways: not stipulated
(15)	Airports	Not stipulated
(16)	Ports and harbors	Not stipulated
(17)	Sewage and wastewater treatment having sensitive characteristics or located in sensitive areas or their vicinity	Red
(18)	Waste management and disposal	- waste incineration plant and landfill: Red - others: not stipulated
(19)	Agriculture involving large-scale land-clearing or irrigation	Many in this sector: Orange-A
(20)	Forestry	Not stipulated
(21)	Tourism (construction of hotels, etc)	Not stipulated
2. Sensitive Characteristics		
(1)	Large-scale involuntary resettlement	Not stipulated
(2)	Large-scale groundwater pumping	Not stipulated
(3)	Large-scale land reclamation, land development and land clearing	Not stipulated
(4)	Large-scale logging	Not stipulated
3. sensitive areas		
(1)	National parks, nationally-designated protected areas	Not stipulated
(2)	Areas considered to require careful consideration by the country or locality	Not stipulated

Source: JBIC Bangladesh environmental profile, 2006

6.9 Expected impact[6]

(1) It is expected that the project will support xx SMEs in their efforts to increase investment in equipment and facilities.

[6] Operation/ Effect Indicators shall be set in the next phase survey.

(2) It is expected that the project will provide banks and financial institutions with a good model to support the investment needs of SMEs with medium-and long-term loans. This will be evaluated by examining the number of PFIs that received JICA loan proceeds and which have increased medium and long-term loans to SMEs with their own funds

(3) Productivity of SMEs will be enhanced with investment in productive equipment and facilities. Productivity increase will be evaluated through a sample survey of SMEs that received sub-loans under the JICA project. The study will be made on the extent to which SMEs increased their labor productivity.

Annex 1: Results of the SME interview survey

1. Background

As part of the survey, the local consultant under the guidance of the JICA Survey Team visited 35 SMEs for the interview survey. The number was far short of applying statistical inference for generalization and those interviewed were not picked up through the random sampling method. The total number of SMEs in the country is innumerable, in thousands, covering varieties of activities in all economic sectors including manufacturing. The interviews with SMEs were intended to obtain a general profile of target beneficiaries at the time of the survey. The number of SMEs that the team originally planned to visit was about 20, but with the arrangement and courtesy extended by the light engineering association, the local consultant was able to visit more SMEs in the light engineering sector. Later on 15 samples were interviewed other than light engineering to give a feel of multi-sector beneficiaries.

2. Profile of SMEs visited

(1) Location

The interview survey was conducted in Dhaka and other major local cities in Rajshahi, Khulna and Shylet divisions. Rajshahi is agriculture surplus area and grainery of the country and economy of the division is dependent on agriculture and crop production. It also supplies fruits and vegetables to Dhaka and rest of the country. Bogra in Rajshahi Division is known for the cluster formation in the light engineering sector to support agriculture sector mechanization such as irrigation pumps and other agriculture equipments. Districts in Shylet Division are famous for tea production and processing. The light engineering sector in Shylet is related to machinery and spare parts relevant to tea production. Khulna Division is known for jute and jute goods production. The light engineering in Khulna supported the jute industries. Jessore district under Khulna Division is an emerging light engineering cluster mainly involved in spare parts of transport sector vehicles and assembling of improvised medium type motor vehicles (local version). The following table shows the number of SMEs interviewed by division and district.

Table A1- 1: Number of SMEs interviewed by division and district

Division	District (Zila)	Number of SMEs
Dhaka	Dhaka	**11**
Rajshahi	Bogra	**6**
	Saidpur	**1**
Khulna	Khulna	**8**
	Jessore	**2**
Sylhet	Moulvibazar	**5**
	Srimongal	**1**
	Sylhet	**1**
Total		**35**

(2) Start-up year of enterprises

About 60% of the enterprises visited was established 1990 or before.

Table A1- 2: Start-up year

Start-up year	Frequency
1990 or before	20
1991 to 2000	6
2001 to 2005	4
2006 to 2010	4
Total	34

(3) Type of SMEs
Most of the enterprises are sole proprietorship. Only four are classified into limited companies.

Table A1- 3: Type of company

Type of company	No. of SMEs
Sole proprietorship	29
Partnership	2
Limited company	4
Total	35

(4) Type of industries
A total of nine sectors have been covered. They are food stuff (e.g. flours, shrimp, fish and eggs), jute, cotton & wearing apparel industries (ladies fashion wear), leather and leather products (ladies shoes and sandals), paper products, chemical products (cover of auto-rickshaw), non-metallic products (parts for tea machinery), engineering industries (pumps, tea machineries), electricity & fuel industries (battery plates, cables), others (compost fertilizer, electrical merchandise).

Table A1- 4: Type of industries

Code	Types of industries	Number of SMEs
1	Food Stuff (manufacturing and processing industries)	3
3	Jute, Cotton & Wearing Apparel Industries	1
4	Leather & Leather Products	2
5	Manufacturing of Paper, Paper Products & Printing	1
7	Manufacturing of Chemical & Chemical Products, Plastic & Rubber Products	2
8	Manufacturing of Non-Metallic Mineral Products	1
9	Engineering. Basic Metal & Metal Products	22
11	Electricity & Fuel Industries	1
14	Other Industries	2
Total		35

The following is a cross tabulation of locations of SMEs and industrial sectors they belong.

Table A1- 5: Location and industrial sectors

Code	Sector	Location								Total
		Bogra	Dhaka	Jessore	Khulna	Moulvibazar	Saidpur	Srimongal	Sylhet	
1	Food Stuff (manufacturing and processing industries)	0	0	1	2	0	0	0	0	3
3	Jute, Cotton & Wearing Apparel Industries	0	1	0	0	0	0	0	0	1
4	Leather & Leather Products	0	2	0	0	0	0	0	0	2
5	Manufacturing of Paper, Paper Products & Printing	0	0	0	1	0	0	0	0	1
7	Manufacturing of Chemical & Chemical Products, Plastic & Rubber Products	0	1	0	0	0	1	0	0	2
8	Manufacturing of Non-Metallic Mineral Products	0	0	0	0	0	0	0	1	1
9	Engineering. Basic Metal & Metal Products	6	6	1	3	5	0	1	0	22
11	Electricity & Fuel Industries	0	0	0	1	0	0	0	0	1
14	Other Industries	0	1	0	1	0	0	0	0	2
	Total	6	11	2	8	5	1	1	1	35

3. Number of workers and level of education

(1) Number of workers

Out of 35 SMEs that responded to this question, 16 SMEs employ less than 25 workers. SMEs with workers up to 50 account for about 80%. The average and median sizes of workers are 37 and 25, respectively, ranging from 5 to 210.

Table A1- 6: Number of workers

No.	Number of workers	Number of SMEs
1	Up to 24 persons	16
2	Between 25 and 50	13
3	Between 51 and 99	4
4	Between 100 and 150	1
5	Between 151 and 250	1
Total		35

(2) Level of education

A total of workers at 35 SMEs numbers 1,289 persons, out of which non-permanent employees are 258. More than half of workers received only primary education.

Table A1- 7: Level of education

No.	Level of Education	Number of workers (persons)
1	Degree or Above	53
2	Senior High School	203
3	Junior High School	221
4	Vocational Training Center	59
5	Primary School	696
6	Others	57
Total		1,289
Out of which: Non Permanent		258

4. Estimated value of machinery and equipment

(1) Estimated value of machinery

The value of machinery is estimated from the historical acquisition costs. The average and median values are Tk 6.1 million and Tk 3.0 million, respectively. The following table shows the distribution of the estimated value of machinery and other equipment and facilities. It is found out that 17 SMEs out of 35 have their values less than 3.0 million.

Table A1- 8: Estimated value of machinery and equipment

No.	Estimated value of machinery, other equipment and facilities (Tk million)	Number of SMEs
1	Less than Tk 1.00 million	6
2	Tk 1.00 million to 2.99 million	11
3	Tk 3.00 million to 4.99 million	7
4	Tk 5.00 million to 9.99 million	4
5	Tk 10.00 million to 14.99 million	2
6	Tk 15.00 million to 19.99 million	3
7	Tk 20.00 million to 50.00 million	2
Total		35

(2) Comparison of estimated value of machinery & plant and number of workers

The following diagram plots value of machinery and plant on the x-axis and the number of workers up to 100 on the y-axis. The value of the machinery shows correlation with the number of workers.

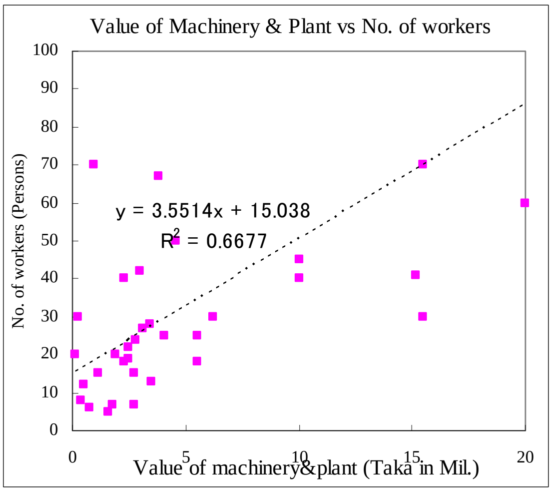


Figure A1- 1: Value of Machinery and Plant vs No. of workers

5. Sales

(1) Sales in 2009

34 SMEs responded to the question on sales in 2009. More than half of the SMEs interviewed answered with the annual sales being less than Tk 10 million, but 14 SMEs replied that their sales go beyond Tk 10 million and 2 SMEs even Tk 50 million.

Table A1- 9: Sales in 2009

No.	Sales in 2009	Number of SMEs
1	Less than Tk 5.0 million	9
2	Tk 5.0 million to less than Tk 10 million	9
3	Tk 10.0 million to less than Tk 20 million	7
4	Tk 20.0 million to less than Tk 50 million	7
5	Tk 50.0 million to less than Tk 100 million	2
Total		34

(2) Prospect over the next three years

SMEs were asked to evaluate the future prospects of their sales and profits. Most of the SMEs interviewed are expecting the steady growth of their business over the next three years. Two SMEs, however, made reservations for such prospects to hold. It is the electricity issue that they mentioned as a factor to influence the prospects.

Table A1- 10: Prospect over the next three years

		Sales	Profit
1	Growing Sharply	4	4
2	Growing Steadily	29	28
3	Stays Flat	1	2
4	Fluctuate Year by Year	1	1
5	Decreasing Steadily	0	0
6	Decreasing Sharply	0	0
Total		35	35

6. Current business issues

The question was raised to find out the most serious business issue that SMEs faced at present. Probably having known the purpose of interviews, many SMEs responded with the working capital and also investment financing. Other than financing issues, access to appropriate utilities, particularly electricity, is the most important issue among SMEs. SMEs that pointed out "employment of workers" as an issue added some explanations such as increase in wages, high rate of absenteeism and surplus labor. The serious business issues at the start-up time shows similar patterns, but procurement of raw materials (No.10), space (No.13) and market access (No.2) seem to draw more attention at the beginning stage of business.

Table A1- 11: Current business issues

No.	Current serious business issues	No. of SMEs
1	Unfavorable market change	4
2	Market Access	4
3	Severe competition	5
4	Financing - Working capital	29
5	Financing - Investment financing	13
6	Quality of product/service	5
7	Cost of product/service	6

No.	Current serious business issues	No. of SMEs
8	Access to appropriate technology	8
9	Production Capacity to meet requirements of clients	6
10	Procurement of raw materials	5
11	Employment of workers	11
12	Access to appropriate utilities like water and electricity	13
13	Factory, office, shop, warehouse space	5
14	Compliance with environmental standards to operate the factory	1
15	Government policy & regulation	4
16	No	0
17	Others (12 for electricity and 1 for high interest rate)	13

Note: Multiple choices were allowed.

7. Access to loans

(1) Method of financing the initial investment

In responding to the question about the method of financing the initial investment, 11 out of 33 SMEs answered that they used own personal saving (100%) and 20 answered that they partly used own personal saving and combined it with other sources. Most common other sources are borrowing form family and/or relatives (interest free) (15 SMEs), followed by banks (7 SMEs). None of them used MFIs and money lenders.

(2) Method of financing the initial working capital

In terms of the initial working capital, 13 out of 33 SMEs responded that they used own personal savings (100%) and 12 SMEs answered that they combined their personal savings with other sources such as borrowings from family and friends, and banks.

(3) Loans received in the past

Out of 35 SMEs, 20 SMEs answered that they had borrowed loans in the past. The total number of loans that 20 SMEs received was 25, 21 loans from banks and 4 loans from NBFIs. The average and median loan sizes were Tk 4.8 million and Tk 2.0, respectively. The size distribution of the loans is shown in the table below.

Table A1- 12: Size distribution of the loans

No.	Range of loan size	Number of SMEs
1	Equal or less than Tk 0.5 million	4
2	Tk 0.51 million to equal or less than Tk 1.0 million	4
3	Tk 1.01 million to equal or less than Tk 3.0 million	10
4	Tk 3.1 million to equal or less than Tk 5.0 million	0
5	Tk 5.1 million to less than Tk 10.0 million	4
6	Tk 10.1 million to less than Tk 15.0 million	1
7	Tk 15.1 million to less than Tk 30.0 million	2
Total		25

1) Types of loans

In terms of the purpose, four loans were for the purely investment purpose, ten were for purely working capital needs and the rest was for a mixture of investment and working capital needs.

Table A1- 13: Type of loans

Purpose of borrowing	**Number of loans**
Investment	4
Working capital	10
Mixture of investment and working capital	11
Total	25

2) Collateral requirements

Most of the loans required collaterals in the form of land and other fixed assets. Among 25 loans, only one enterprise responded with the collateral free loan in the amount of Tk 2.0 million.

Table A1- 14: Type of collateral

Types of collaterals	Number of loans
Land (and building/machinery)	16
House	2
Factory assets	2
Materials hypothecated	2
Advance installments and personal guarantee	1
No collateral	1
No answer	1
Total	25

3) Duration of loans

Duration of most of the loans was 12 months, but renewable. Three enterprises answered their loan durations were 10 years or longer. These three enterprises failed to pay as scheduled, and the lenders declared defaults for them.

Table A1- 15: Duration of loans

Duration of loans	Number of loans
12 months (and or renewable)	13
24 months	4
36 months	2
48 months	1
10 years or longer	3
No answers	2
Total	25

4) Interest rates of loans

Interest rates varied from 10% to 20%. The following table shows the highest, lowest and average interest rates for respective size of enterprises by the number of workers for loans taken.

Table A1- 16: Interest rate of loans (by size of firms)

No.	Number of workers	Count	Lowest	Average	Highest
1	Up to 9 persons	3	12%	13.2%	14%
2	Between 10 and 49	16	13%	14.8%	20%
3	50 or over	6	11%	13.0%	15%
Total/average		Total 25	11%	Average 14.1%	20%

Note: When a SME responded with a range of interest rates, an average was taken for the analysis.

Table A1- 17: Interest rate of loans (by loan duration)

No.	Duration	Count	Lowest	Average	Highest
1	12 months or less (incl. 1 year renewable)	13	13%	13.8%	17%
2	Over 12 months up to 24 months	4	13%	16.0%	20%
3	Over 24 months	3	12%	14.7%	18%
Total/average		Total 20	12%	Average 14.4%	20%

Note: When a SME responded with a range of interest rates instead of a single number, an average was taken for the analysis. SMEs for which default was declared have been excluded from the analysis. SMEs that did not answer the duration of loans have been excluded from the analysis as well.

The following table shows the average interest rate by size of enterprises for loans with same durations.

Table A1- 18: Interest rate of loans by duration and size of firms

Number of workers	No. of SMEs	Average interest rate
Loan duration is 12 months or less		
Less than 50	9	14.1%
50 or over	4	13.0%
Loan duration is longer than 12 months		
Less than 50	7	15.4%

(4) SMEs that did not borrow loans

SMEs that did not borrow loans were asked the reason why they did not borrow from a bank/financial institutions. As seen from their responses, those who answered this question point out that SMEs did not have interest in borrowing from bank and also they did not have knowledge on borrowing from a bank.

Table A1- 19: Reasons for not borrowing

No.	Reason for Not Borrowing	No. of SMEs
1	The company had no need of funds.	1
2	The company needed funds but funds were ready from other sources.	0
3	The company needed funds. But it did not access any bank because it did not have any relation with bank.	3
4	The company needed funds. But it did not access any bank because it did not have knowledge on borrowing from a bank.	5
5	The company needed funds. But it did not have interest in borrowing from bank.	6

No.	Reason for Not Borrowing	No. of SMEs
6	The company negotiated with a bank for loan, but failed to borrow.	0
7	Others (please specify)	1 (high interest)

Note: Multiple choices were allowed.

SMEs were also asked reasons why they did not negotiate with a bank/FI for loan, or failed to borrow from a bank/FI. As seen from the table below, the most frequently cited choice was a high interest rate (8 SMEs), followed by difficulties in satisfying the lending criteria of banks and financial institutions.

Table A1- 20: Reasons of not negotiating/ fail to borrow from Banks/ Financial Institutions

No.	Reason of not negotiating or fail to borrow from Banks/Financial Institutions	No. of SMEs
1	No existence of bank/FI office in a reachable geographical location	0
2	Absence of banks/FIs offering medium/long term loan	0
3	Banks/FIs were reluctant to lend to SMEs	1
4	Banks/FIs had no access to medium/long term funds (Banks/FIs did not provide medium/long-term loans)	1
5	Banks/FIs were short of lending officers	0
6	Banks/FIs had no knowledge of SME business	0
7	Banks/FIs stuck to the collateral of land or fixtures	4
8	Banks/FIs' procedures were too complicated	4
9	Banks/FIs lending criteria were too difficult to satisfy.	5
10	We were unable to prepare the business plan required by the banks/FIs	1
11	We failed to prepare and submit the financial statements	0
12	We were not audited	0
13	We were unable to submit the collateral	4
14	The interest rate offered by the bank/FIs was too high	8
15	Bank/FI officers demanded extra money for handling the loan	0
16	Others (please specify)	0

Note: Multiple choices were allowed.

The issue of the collateral (Item No.7) seems to be less important for SMEs that did not borrow, if compared to the issue of high interest rate. However, when SMEs are asked to evaluate the attitude, capability and performance of banks and financial institutions, many responding SMEs pointed out collateral issues.

Table A1- 21: Banks/ Financial Institutions' Attitude

No.	Banks/Financial Institutions' Attitude in Lending to SMEs	No. of SMEs
1	Banks/financial institutions do not carry proactive policies for lending to SMEs.	7
2	Banks/financial institutions are reluctant to lend new money regardless of the type of projects.	0
3	Banks/financial institutions do not lend money on the basis of project's viability.	1
4	Banks /financial institutions stick to collateral.	23
5	Banks/financial institutions generally lack the capability to appraise projects of SMEs.	2

No.	Banks/Financial Institutions' Attitude in Lending to SMEs	No. of SMEs
6	Banks/financial institutions are tough in providing medium/long term loan, while easy in providing working funds.	0
7	Banks/financial institutions charge too high interest that enterprises cannot bear.	25
8	Repayment periods set by banks/financial institutions are too short.	4
9	Banks/financial institutions take too long time in appraising the loan application.	4
10	Banks/financial institutions do not assist SMEs in preparing the project plan.	5
11	Banks/financial institutions do not provide assistance/advice in implementation of the projects.	3
12	Others (please specify) Since women entrepreneur, bank ignores SME, No SME loan available in banks	4

Note: Multiple choices were allowed.

(5) Needs of loans

In responding to questions on needs for new loans, 22 out of 35 SMEs responded with the amount of loans for investment loans and 24 for working capital loans. The average and median values of investment loans were Tk 50.7 million and Tk 5.0 million, respectively. On the other hand, for working capital loans, the average and median amounts were Tk 34.6 million and Tk 5.0 million, respectively. The amount they desire to borrow is more than twice as big as the loan size that some of the SMEs borrowed in the past.

Table A1- 22: Needs for the new borrowing (No. of SME responded with the amount)

Range of amount of loans needed	Investment loans	Working capital loans
Up to Tk 1 mil.	2	4
Over Tk 1 mil up to Tk 3 mil.	6	8
Over Tk 3 million up to Tk 5 mil.	6	3
Over 5 mil up to Tk 10 mil	3	6
Over Tk 10 mil up to Tk 30 mil	2	2
Over Tk 30 mil up to Tk 100 mil	1	3
Over Tk 100 mil up to Tk 600 mil	3	1
Total	23	27

As for the conditions of the loans, SMEs expressed their preferences. In terms of the rate of interest SMEs are prepared to pay, most of the SMEs chose single digit interest rates.

Table A1- 23: Preferred range of interest rate

No.	Range of Interest Rate	No. of SMEs
1	Over 20% per annum (Over monthly rate 1.67%)	0
2	Less than 20% but exceeds 15% p.a. (Less than monthly rate 1.67% but exceeds 1.25%)	0
3	Less than 15% but exceeds 10% p.a. (Less than monthly rate 1.25% but exceeds 0.83%)	2
4	Less than 10% but exceeds 5% p.a. (Less than monthly rate 0.83% but exceeds 0.42%)	19
5	Less than 5% p.a. (Less than 0.42%)	6
Total		27

Note: In addition to the number of SMEs above, another three SMEs chose a range from No.4 to No. 5.

As for the acceptable period for repayment, 14 SMEs chose a period from 5 up to 10 years.

Table A1- 24: Preferred range of repayment period

No.	Repayment Period	No. of SMEs
1	Over 10 years	4
2	Less than 10 years but exceeds 5 years	14
3	Less than 5 years but exceed 3 years	7
4	Less than 3 years but exceed 1 year	4
5	Less than 1 year	0
Total		29

(9) Needs of technical assistance

SMEs were asked to point out areas that they wished to receive guidance in terms of financing and bank borrowing. Many SMEs responded with concrete and practical requests such as investment planning and evaluation, financial management and preparation of loan application and financial statement. No SMEs surveyed needed introduction of banks and financial institutions. In fact, it was found out that all the SMEs surveyed had already opened accounts at banks and or financial institutions. However, with regard to preparation of an annual business plan, 31 SMEs replied that they did not prepare it. In case of the financial statements and external audit, only 12 SMEs prepared the financial statements every year and 4 SMEs had external auditors audit the financial statement every year.

Table A1- 25: Needs of technical guidance / assistance (financing and others)

No.	Type of Guidance/Assistance	No of SMEs
1	Advisory & consulting service on how to start transaction with banks/financial institutions	0
2	Advisory & consulting service on how to prepare loan application	8
3	Advisory & consulting on accounting and how to prepare financial statements	8
4	Advisory & consulting on financial management	9
5	Advisory & consulting on tax management	8
6	Advisory & consulting on investment planning and evaluation	12
7	Introduction of banks/financial institutions to your company	0
8	Others (Please specify: Financing machine tools)	1

Note: Multiple choices were allowed.

In terms of management, SMEs were asked to choose types of guidance and assistance they wish to receive. Their response revealed that workers' training was the area as many as 22 SMEs pointed out. This is followed by technical advice on production management and production technology, material and product testing.

Table A1- 26: Needs of technical assistance (management and others)

No.	Type of Guidance/Assistance	No of SMEs
1	Advisory & Consulting Service on Management and Business Planning	3
2	Advisory & Consulting Service When Starting Business	1
3	Provision of Legal Advice	2

No.	Type of Guidance/Assistance	No of SMEs
4	Provision of Technical Advice on Production Management	14
5	Provision of Technical Advice on Production Technology	17
6	Information Provision - Market and Customer Information	8
7	Information Provision - Technology Information	9
8	Marketing support (exhibition, trade fair, etc.)	10
9	Workers' Training	22
10	Provision of Opportunities for Cooperation with Other Companies	2
11	Material/Product Testing	12
12	Others Please specify Establishment of industrial park	1

Note: Multiple choices were allowed.

Annex 2: Priority Sectors (Thrust Sectors) List in the draft Industrial Policy 2010

The Thrust Sector Industries refers to those promising manufacturing industries which have the potential to contribute to overall growth in industrial production, employment generation, to boost export earning, and to contribute to poverty reduction in a massive way and which need patronization for their full blown expansion. The government will continue giving support and extending facilities to them on a priority basis until the fixed period for maturity is over. The government will declare any sector or sub-sector to be identified and recognized as the Thrust sector on the basis of set criteria considering different economic factors. The priority sector will receive special incentives and financial assistance from the government.

1. Agro-based and agro-product/food processing industries
2. Manpower export
3. Ship Building
4. Renewable Energy (solar power, wind mills)
5. Tourism Industry
6. Basic Chemicals, Dye and Chemicals
7. ICT products and ICT services
8. Readymade Garments Industry (value added garment products are a priority)
9. Active Pharmaceutical ingredients industry and radio pharmaceutical industry
10. Herbal Medicine
11. Radioactive ray application for preservation of food and other articles
12. Polymer industries
13. Jute products
14. Leather and Leather goods industries
15. Hospitals and Clinics
16. Light Engineering Industries
17. Plastic Industries
18. Furniture Industries
19. Handicrafts
20. Energy Efficient Appliances/Electronic equipments/Electronic Material Improvement
21. Frozen fish
22. Tea Industries
23. Home Textiles
24. Ceramics (Ceramic utensils, table wares, tiles and sanitary products)
25. Tissue Grafting and Biotechnology
26. Jewelry
27. Toys
28. Container services
29. Warehouses
30. Innovative and Import Substitute products

Annex 3: Finance, organization and wholesale program of SME Foundation

(1) Finance

The resources of SMEF can consist of: (1) grants made by the Government, (2) funds and donations, grants, loans or other financial assistance from the Government, private or any other sources including agencies and institutions in Bangladesh and abroad, (3) fees and charges imposed by the SMEF, (4) income from investments, and (5) income and receipts from other sources. As of the time of this survey (March 2010), the total endowment of SMEF amounts to Tk 2.0 billion, the budgetary grant from the Government. Although SMEF is not able to sanction and/or deal in direct credit delivery to SMEs, it can provide funds to banks and financial institutions for relending to SMEs. In accordance with the requirements of Section 28 of the Companies Act, 1994, however, SMEF is prohibited to pay any dividend to its members.

The following tables show the financial conditions of SMEF during FY 2008-09. Most of the income is government grants, amounting to Tk 49.9 million. The amount of the endowment fund was about one Billion Tk at end of June 2008. The balance sheet shows the conditions when the wholesale program of the SMEF was yet to be operational.

Table A3- 1: Income & Expenditure Accounts (For the year ended June 20, 2008)

Description	Amount in Tk Million
Income	60.5
Expenditure	27.3
Excess of income over expenditure	33.2

Source: SMEF, Annual Report 2008-09

Table A3- 2: Balance Sheet (As of June 20, 2008)

Description	Amount in Tk Million
Funds and Liabilities	
Capital Fund	1,034.8
(Endowment fund)	(1,001.6)
Excess of income over expenditure	12.5
Total	1,047.3
Properties and Assets	
Fixed assets	1.6
Current assets	0.03
Other current assets	1,045.7
Total	1,047.3

Source: SMEF, Annual Report 2008-09

(2) Organization

SMEF is structured with three major divisions: policy advocacy and gender equality; administration and finance; technology & enterprise support services. As of June 2009, staff members of SMEF totaled 36, including 29 officers, against the approved set-up of 56. The Foundation provides various services ranging from policy advocacy to capacity development, women entrepreneurship development, access to information, business support services, access to technology, access to finance and so on. Thus, SMEF is working on a rather broad scope of works considering the existing level of the workforce.

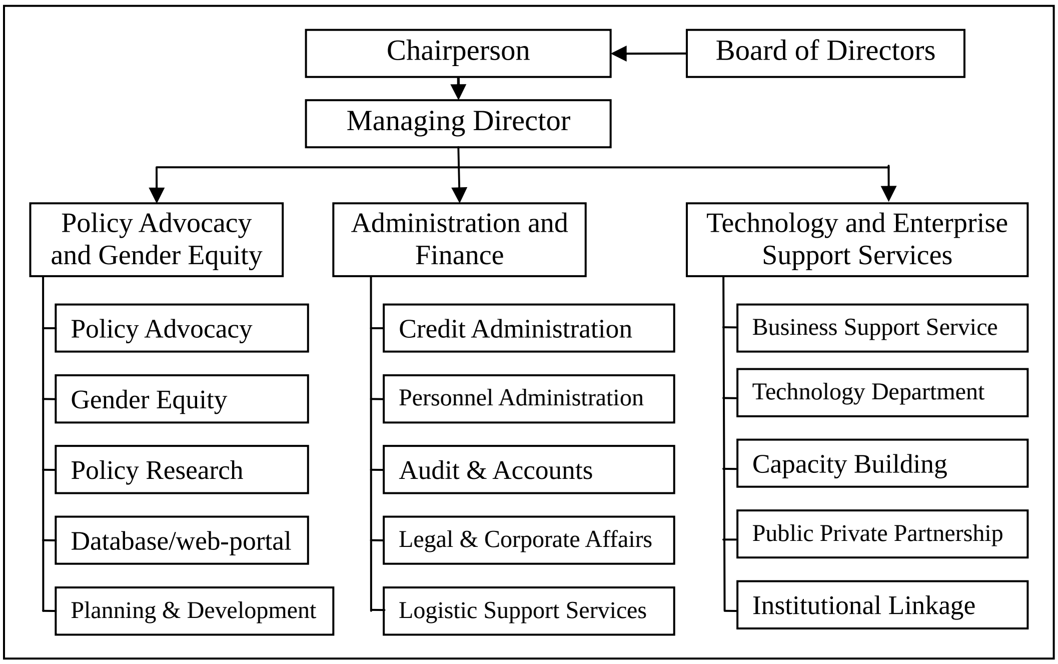


Figure A3- 1: Organizational structure of SMEF

(3) Wholesale program

As part of its efforts to strengthen access for SMEs to finance, SMEF has been implementing the two pilot programs, one with MIDAS Financing Ltd. (a NBFI) and another with Shakti Foundation (a MFI)[1].

Total fund	: Tk 20 million (Tk 10 million each)
Target Sector	: Only manufacturing based SMEs
Sub-loan	: Tk. 50,000 to 500,000/-
Tenure	: 2 Years from 1st disbursement
Service Charge by SMEF	: 3% p.a.
Rate of Interest to SMEs	: 9% p.a. (to be calculated on reducing balance)
Other Charges	: Maximum 0.5%
Condition	: No collateral could be taken against the loans from SMEF
Financing method	: Pre-financing

The following tables show the profiles of the clientele of two different financial institutions. A number of observations can be made by comparing these two tables. Firstly, the average loan size ranges from Tk 0.25 Million to Tk 0.40 Million although the range has been set to vary from Tk 0.05 Million to Tk 0.5 Million. Most of the loan is used as working capital. Secondly, the differences in performance between MIDAS Financing and Shakti Foundation may have resulted from the difference between the domains in which they operate. While MIDAS Financing, as an NBFI, deals with a bigger segment of SMEs, Shakti Foundation, as an MFI, usually focuses on a smaller segment of SMEs, sometimes called micro enterprises. A stark difference in the share of women entrepreneurs out of the total number of enterprises funded also provides convincing evidence for this observation. Thirdly, these two organizations can be characterized by their different outreach profiles. While MIDAS Financing operates outside Dhaka in places such as Bogra, Shakti Foundation operates mainly in Dhaka. Lastly, the sector

[1] SMEF and MIDAS Financing agreed to conclude another loan of Tk 20 million in May 2010. Under the new loan, the SMEF service charge will be increased to 4% p.a. and the upper limit of sub-loans will be increased to Tk 0.7 million. SMEF plans to conclude loans with two more commercial banks.

distribution of the disbursement shows that light engineering and the dress-making/fashion design sectors, both of which were selected as booster sectors under the SME policy strategies 2005, account for a larger share of the total amount disbursed.

Table A3- 3: Midas Financing (including both initial disbursed amount and revolving fund)

Types of Industry	No. of Enterprises (Women)	Amount disbursed in Mil.Tk	Share	Amount per loan in Mil.Tk	Location
Light Engineering	18 (0)	5.7	45%	0.32	Bogra: 12; Dhaka: 4 & Comilla: 2
Dress-Making/ Fashion Design	21 (9)	5.6	44%	0.27	Dhaka: 11; Narayanganj: 7 & Bogra: 2, Comilla 1
Agro-based (Food Processing)	1 (0)	0.4	3%	0.40	Chittagong: 1
Others	4 (2)	1.0	8%	0.25	Comilla: 2, Feni:1, Ctg: 1
Sub-total	44 (10)	12.7	100%	0.29	

Source: SMEF
Note: The number of women enterprises does not add up.

Table A3- 4: Shakti Foundation

Types of Industry	No. of Enterprises (Women)	Amount disbursed in Mil.Tk	Share	Amount per loan in Mil.Tk	Location
Light Engineering	4 (4)	1.28	46%	0.32	Dhaka: 4
Dress-Making/ Fashion Design	6 (6)	1.2	43%	0.20	Dhaka: 5 & N.Ganj: 1
Fast Food	1 (1)	0.3	11%	0.30	Dhaka: 1
Total	11 (11)	2.78	100%	0.25	

Source: SMEF

Annex 4: Comparison of performance of banks and financial institutions

Table A4- 1: Business Performances of State Commercial Banks (2009)

Unit: Taka Billion

	Sonali Bk	Janata Bk	Agrani Bk	Rupali Bk	Ave
Balance Sheet & Income Statement					
Paid-up Capital	9.00	5.00	4.97	1.25	5.06
Net Worth	30.48	17.09	9.17	5.58	15.58
Total Deposits	406.15	246.18	166.28	73.91	223.13
Total Loans & Advances	254.02	166.36	122.24	52.34	148.74
Interest Income	17.68	14.87	10.12	4.98	11.91
Investment & Fee Income	14.88	9.21	7.24	2.26	8.40
Operating Expense	14.45	5.12	3.84	1.90	6.33
Net Profit	2.24	3.00	1.11	1.67	2.01
Financial Health					
Capital Adequacy Ratio (%)	11.67%	13.57%	10.80%	-17.58%	4.62%
Advance to Deposits (%)	62.54%	67.58%	73.51%	70.82%	68.61%
Med/Long Term Deposit Ratio (%)	58.92%	39.22%	76.27%	50.20%	56.15%
Med/Long Term Loan Ratio (%)	42.70%	41.45%	56.37%	38.81%	44.83%
Non-Performing Loans (%)	27.49%	8.70%	19.42%	20.91%	19.13%
Maturity Matching (%)	130.72%	109.88%	73.88%	73.40%	96.97%
Profitability					
Return on Assets (%)	0.42%	1.00%	0.52%	1.17%	0.78%
Return on Equity (%)	7.36%	17.58%	12.09%	2.40%	9.86%
Ave Yield on Loans & Advances (%)			11.04%	8.15%	9.60%
Ave Cost of Deposit (%)		4.58%	3.88%	4.40%	4.29%
Cost of Funds (%)	6.30%	6.96%		7.20%	6.82%
Operating Cost (%)		2.38%			2.38%
Net Interest Margin (%)			4.61%	0.41%	2.51%
Efficiency					
No. of Branches	1,182	849	867	492	340
No. of Employees	21,839	13,379	10,988	4,269	3,814
Ave Loan Bal/Employee (Tk thousand)	11,631.48	12,434.41	11,124.86	12,260.48	5,846
Net Profit/Employee (Tk thousand)	102.57	224.23	101.02	391.19	123
					Total
Med/long term Deposit (A)	239.3	96.6	126.8	37.1	499.78
Med/long term Loan (B)	108.5	69.0	68.9	20.3	266.64
(A)-(B)	130.84	27.60	57.92	16.79	
Sum of ((A)-(B)) if ((A)-(B))<0)	0.00	0.00	0.00	0.00	0.00

Note: [yellow] =2008

[orange] =to be watched with care

Cost of Funds = interest expense/average borrowing & deposits

Net Interest Margin = net interest income/average earning assets

Maturity Matching = total assets whose maturity exceeds one year excluding premises, fixtures and furniture divided by total liabilities of maturity longer than one year.

Table A4- 2: Business Performances of Specialized Banks (2009)

Unit: Taka Billion

	Krishi Bk	RAKUB	BASIC	BDBL	Ave
Balance Sheet & Income Statement					
Paid-up Capital	3.00	2.20	1.31		2.17
Net Worth	-19.41	-0.42	2.99		-5.61
Total Deposits	80.31	15.39	38.37		44.69
Total Loans & Advances	89.14	27.11	27.27		47.84
Interest Income	5.72	18.71	3.83		9.42
Investment & Fee Income	0.79	1.00	1.23		1.01
Operating Expense	2.75	1.02	0.82		1.53
Net Profit	-1.97	-0.64	0.55		-0.69
Financial Health					
Capital Adequacy Ratio (%)			12.02%		12.02%
Advance to Deposits (%)	110.99%	176.15%	71.73%		119.62%
Med/Long Term Deposit Ratio (%)			14.88%		14.88%
Med/Long Term Loan Ratio (%)			26.44%		26.44%
Non-Performing Loans (%)	26.45%	34.34%	4.59%		21.79%
Maturity Matching (%)		108.74%	135.00%		121.87%
Profitability					
Return on Assets (%)	-1.66%		1.30%		-0.18%
Return on Equity (%)					
Ave Yield on Loans & Advances (%)					
Ave Cost of Deposit (%)					
Cost of Funds (%)	7.91%	8.30%	8.36%		8.19%
Operating Cost (%)					
Net Interest Margin (%)					
Efficiency					
No. of Branches			31		31
No. of Employees			735		735
Ave Loan Bal/Employee (Tk thousand)			37,102.04		37,102
Net Profit/Employee (Tk thousand)			748.30		748
					Total
Med/long term Deposit (A)	0.0	0.0	5.7		5.7
Med/long term Loan (B)	0.0	0.0	7.2		7.2
(A)-(B)	0.00	0.00	-1.50		
Sum of ((A)-(B)) if ((A)-(B))<0)	0.00	0.00	-1.50		-1.50

Note: [yellow] =2008

[orange] =to be watched with care

Cost of Funds = interest expense/average borrowing & deposits

Net Interest Margin = net interest income/average earning assets

Maturity Matching = total assets whose maturity exceeds one year excluding premises, fixtures and furniture divided by total liabilities of maturity longer than one year.

Table A4- 3: Business Performances of Private Commercial Banks (2009)

Unit: Taka Billion

	Pubali	Uttara	AB Bk	IFIC	Islami	Natl Bk	The City	United Com	ICB Islam	Eastern	NCCBL	Prime	SouthEast	Dhaka	Al-Arafah	SIBL
Balance Sheet & Income Statement										(Consolidaed)		(Bank)		(Consolidaed)		
Paid-up Capital	3.82	1.60	2.56	1.74	6.18	2.87	1.37		6.65	2.50	1.76	3.55	3.42	2.13		
Net Worth	9.51	6.21	10.22	4.20	23.62	8.93	4.22		-2.93	8.43	4.06	11.75	11.33	4.97		
Total Deposits	88.47	59.39	83.09	50.02	244.29	76.83	45.03		13.01	49.19	46.90	106.96	96.67	60.92		
Total Loans & Advances	74.20	39.45	70.88	37.79	214.62	65.13	34.42		14.76	47.67	46.33	89.25	77.50	52.91		
Interest Income	8.06	4.49	9.11	3.87	21.37	6.82	4.67		0.53	6.22	5.45	10.83	8.96	7.47		
Investment & Fee Income	2.61	2.90	5.41	2.62	4.03	4.22	2.00		0.21	2.47	1.97	5.79	4.74	2.18		
Operating Expense	3.06	2.09	2.50	1.76	4.55	3.14	1.76		0.36	1.65	0.95	2.91	1.24	1.42		
Net Profit	2.09	1.11	3.42	0.90	3.40	2.08	0.40		-0.78	1.45	0.88	2.78	1.87	0.96		
Financial Health																
Capital Adequacy Ratio (%)	13.63%	15.81%	11.09%	13.50%	11.65%		11.01%		-114.15%	16.84%	10.61%	14.71%	11.72%	11.31%		
Advance to Deposits (%)	83.88%	66.43%	85.31%	75.56%	87.85%	84.77%	76.43%		113.45%	96.91%	98.78%	83.45%	80.17%	86.85%		
Med/Long Term Deposit Ratio (%)	30.37%	36.53%	26.33%	27.03%	46.00%		9.54%		76.79%	6.21%	23.64%	31.53%	15.50%	10.20%		
Med/Long Term Loan Ratio (%)	41.69%	32.02%	30.28%	45.32%	54.00%		45.38%		70.25%	31.30%	29.27%	27.67%	31.90%	39.43%		
Non-Performing Loans (%)	2.96%	7.20%	2.75%	6.14%	2.36%		6.30%		80.42%	2.46%	4.14%	1.29%	3.73%	5.57%		
Maturity Matching (%)	110.05%	126.36%	116.51%	144.76%	98.04%		323.14%		75.18%	302.58%	116.07%	118.11%	212.37%	253.41%		
Profitability																
Return on Assets (%)	1.94%	1.54%	3.52%	1.43%	1.34%		0.75%		-3.93%	2.34%	1.54%	2.37%	1.66%	1.29%		
Return on Equity (%)	22.00%	17.81%		21.43%	16.93%					22.10%	21.76%	30.19%	16.51%	19.32%		
Ave Yield on Loans & Advances (%)																
Ave Cost of Deposit (%)														8.68%		
Cost of Funds (%)	8.66%	4.94%	10.31%	5.45%	8.76%		6.90%		0.31%	7.89%	11.64%	8.41%		10.94%		
Operating Cost (%)																
Net Interest Margin (%)														4.56%		
Efficiency																
No. of Branches	386	211			231					39	57	84	56	50		
No. of Employees	5,375	3,291			9,588					878	1,400	1,844	1,254	924		
Ave Loan Bal/Employee (Tk thousand)	13,804.65	11,987.24			22,384.23					54,293.85	33,092.86	48,400.22	61,802.23	57,261.90		
Net Profit/Employee (Tk thousand)	388.84	337.28			354.61					1,651.48	628.57	1,507.59	1,491.23	1,038.96		
	Tk billion															
Med/long term Deposit (A)	26.9	21.7	21.9	13.5	112.4	0.0	4.3		10.0	3.1	11.1	33.7	15.0	6.2		
Med/long term Loan (B)	30.9	12.6	21.5	17.1	115.9	0.0	15.6		10.4	14.9	13.6	24.7	24.7	20.9		
(A)-(B)	-4.1	9.1	0.4	-3.6	-3.5	0.0	-11.3		-0.4	-11.9	-2.5	9.0	-9.7	-14.6		
Sum of ((A)-(B)) if ((A)-(B))<0)	-4.1	0.0	0.0	-3.6	-3.5	0.0	-11.3		-0.4	-11.9	-2.5	0.0	-9.7	-14.6		

	Dutch-B	Mercantile	One Bk	EXIM	Premier	First Sec	Standard	Trust	Mutual Tr	Bk Asia	BCBL	Jamuna	Shahjalal	BRAC	Ave	
Balance Sheet & Income Statement				(Bank)												
Paid-up Capital	1.50	2.16	1.56	3.37	1.69	2.30	2.20	1.85	1.77	2.14	0.92	1.62	2.74	1.58	2.50	Paid-up Capital
Net Worth	4.35	4.30	2.64	6.72	3.12	2.54	3.43	3.75	3.68	4.95	1.02	3.98	4.93	8.15	6.00	Net Worth
Total Deposits	67.79	55.55	40.39	73.84	31.59	25.85	29.31	43.00	42.35	54.83	6.79	42.36	47.46	75.22	61.37	Total Deposits
Total Loans & Advances	48.41	48.30	33.80	68.61	30.32	25.09	27.19	32.66	52.77	50.27	5.02	32.29	43.96	64.15	52.88	Total Loans & Advances
Interest Income	6.16	6.07	3.04	8.15	3.84	3.14	3.23	4.03	4.28	6.25	0.63	3.79	5.53	9.20	6.12	Interest Income
Investment & Fee Income	4.82	2.18	1.06	2.24	1.23	0.37	0.94	1.55	1.67	2.38	0.10	2.03	1.59	4.28	2.50	Investment & Fee Income
Operating Expense	2.12	1.58	0.60	1.26	0.89	0.38	0.44	1.11	0.92	1.51	0.19	1.01	0.88	3.60	1.63	Operating Expense
Net Profit	1.14	0.81	0.39	1.69	0.65	0.10	0.66	0.54	0.82	1.33	0.03	0.92	1.07	1.37	1.19	Net Profit
Financial Health																
Capital Adequacy Ratio (%)	11.59%	10.48%	10.02%	11.18%	12.71%	16.49%	15.43%	12.66%	13.16%	12.27%		12.83%		12.69%	7.47%	Capital Adequacy Ratio (%)
Advance to Deposits (%)	71.41%	83.22%		92.92%	95.98%	96.39%	92.77%	75.95%	80.00%	91.67%	73.93%	76.23%	92.62%	85.28%	85.70%	Advance to Deposits (%)
Med/Long Term Deposit Ratio (%)	14.42%	70.81%		19.51%	17.47%	15.24%	51.25%	10.82%	9.72%	28.42%		32.49%		44.08%	28.43%	Med/Long Term Deposit Ratio (%)
Med/Long Term Loan Ratio (%)	15.33%	66.22%		39.41%	27.89%	45.76%	28.37%	39.56%	37.46%	21.70%		28.31%		33.44%	37.48%	Med/Long Term Loan Ratio (%)
Non-Performing Loans (%)	2.46%	2.59%		2.68%	5.73%	4.20%	1.89%	2.64%	2.81%	1.56%		2.84%	0.94%	6.04%	6.74%	Non-Performing Loans (%)
Maturity Matching (%)	117.09%	102.46%		161.22%	177.32%	240.11%	117.49%	348.02%	344.09%	146.41%		115.06%		86.02%	171.82%	Maturity Matching (%)
Profitability																
Return on Assets (%)		1.22%	2.37%	2.19%		0.61%	2.15%	1.13%	1.55%	2.18%		1.65%	2.08%	1.56%	1.50%	Return on Assets (%)
Return on Equity (%)		18.80%		28.95%			21.22%		26.61%	26.79%		25.12%		19.19%	22.17%	Return on Equity (%)
Ave Yield on Loans & Advances (%)		13.12%										14.40%			13.76%	Ave Yield on Loans & Advances (%)
Ave Cost of Deposit (%)		8.81%					1.69%							8.49%	6.92%	Ave Cost of Deposit (%)
Cost of Funds (%)				9.09%		11.37%	9.16%	7.88%	10.21%	8.15%			11.07%		8.40%	Cost of Funds (%)
Operating Cost (%)																Operating Cost (%)
Net Interest Margin (%)		3.58%					3.72%								3.95%	Net Interest Margin (%)
Efficiency																
No. of Branches		53	35	52			32		44	33		54		71	93	No. of Branches
No. of Employees		1,303	971				734		841	802		1,215		5,907	2,422	No. of Employees
Ave Loan Bal/Employee (Tk thousand)		37,068.30	34,809.47				37,043.60		62,746.73	62,680.80		26,576.13		10,860.00	38,321	Ave Loan Bal/Employee (Tk thousand)
Net Profit/Employee (Tk thousand)		621.64	401.65				899.18		975.03	1,658.35		757.20		231.93	863	Net Profit/Employee (Tk thousand)
															Total	**Count**
Med/long term Deposit (A)	9.8	39.3	0.0	14.4	5.5	3.9	15.0	4.7	4.1	15.6	0.0	13.8	0.0	33.2	439.0	27
Med/long term Loan (B)	7.4	32.0	0.0	27.0	8.5	11.5	7.7	12.9	19.8	10.9	0.0	9.1	0.0	21.5	491.1	
(A)-(B)	2.4	7.4	0.0	-12.6	-2.9	-7.5	7.3	-8.3	-15.7	4.7	0.0	4.6	0.0	11.7		if negative
Sum of ((A)-(B)) if ((A)-(B))<0)	0.0	0.0	0.0	-12.6	-2.9	-7.5	0.0	-8.3	-15.7	0.0	0.0	0.0	0.0	0.0	-108.7	14

Note: =2008

=to be watched with care

Cost of Funds = interest expense/average borrowing & deposits

Net Interest Margin = net interest income/average earning assets

Maturity Matching = total assets whose maturity exceeds one year excluding premises, fixtures and furniture divided by total liabilities of maturity longer than one year.

Table A4- 4: Business Performances of Foreign Banks (2009)

Unit: Taka Billion

	CB Sri-L	Sta Chart	Habib	SB India	NB Pak	Citi N.A.	Woori	Al Falah	HSBC	Ave	
Balance Sheet & Income Statement	Branch	Branch	Branch	Branch	Branch	Branch	Branch	Branch	Branch		
Paid-up Capital						4.00			2.59	3.30	Paid-up Capital
Net Worth						7.10			9.37	8.24	Net Worth
Total Deposits						31.11			55.62	43.37	Total Deposits
Total Loans & Advances						19.68			31.67	25.68	Total Loans & Advances
Interest Income						2.29			4.59	3.44	Interest Income
Investment & Fee Income						1.71			3.20	2.46	Investment & Fee Income
Operating Expense						0.61			1.27	0.94	Operating Expense
Net Profit						1.22			1.62	1.42	Net Profit
Financial Health											
Capital Adequacy Ratio (%)						29.80%			38.33%	34.07%	Capital Adequacy Ratio 8%)
Advance to Deposits (%)						63.25%			56.94%	60.09%	Advance to Deposits (%)
Med/Long Term Deposit Ratio (%)						7.46%			28.79%	18.13%	Med/Long Term Deposit Ratio (%)
Med/Long Term Loan Ratio (%)						16.53%			42.02%	29.28%	Med/Long Term Loan Ratio (%)
Non-Performing Loans (%)						0.00%			1.46%	0.73%	Non-Performing Loans (%)
Maturity Matching (%)						132.23%			76.63%	104.43%	Maturity Matching (%)
Profitability											
Return on Assets (%)						2.94%			3.63%	3.29%	Return on Assets (%)
Return on Equity (%)											Return on Equity (%)
Ave Yield on Loans & Advances (%)											Ave Yield on Loans & Advances (%)
Ave Cost of Deposit (%)											Ave Cost of Deposit (%)
Cost of Funds (%)											Cost of Funds (%)
Operating Cost (%)											Operating Cost (%)
Net Interest Margin (%)											Net Interest Margin (%)
Efficiency											
No. of Branches											No. of Branches
No. of Employees											No. of Employees
Ave Loan Bal/Employee (Tk thousand)											Ave Loan Bal/Employee (Tk thousand)
Net Profit/Employee (Tk thousand)											Net Profit/Employee (Tk thousand)
	Sri Lanka	Multi-natl	Pakistan	India	Pakistan	Multi-natl	HO=Soeul	HO=Pakistan	Multi-natl	**Total**	**Count**
Med/long term Deposit (A)						2.3			16.0	18.3	2
Med/long term Loan (B)						3.3			13.3	16.6	
(A)-(B)						-0.9			2.7		if negative
Sum of ((A)-(B)) if ((A)-(B))<0)						-0.9			0.0	-0.9	1

Note:
Cost of Funds = interest expense/average borrowing & deposits
Net Interest Margin = net interest income/average earning assets
Maturity Matching = total assets whose maturity exceeds one year excluding premises, fixtures and furniture divided by total liabilities of maturity longer than one year.

Table A4- 5: Business Performances of Non-Bank Financial Institutions (2009)

Unit: Taka Billion

	IPDC	SABINCO	Phoenix	The UAE	GSP Fin	Prime Fin	Oman/ORIX	Bay Ls	IDCOL	BIFC	Union Cap	Islamic Fin	Fidelity	Fareast	Premier Ls	Natl Fin	Haji Fin
Balance Sheet & Income Statement																	
Paid-up Capital	0.78		0.34			0.64			0.50	0.36	0.35	0.32	0.39	0.20			
Net Worth	1.85		0.65			1.83			0.72	0.55	0.49	0.52	0.56	0.37			
Total Deposits	2.33		6.19			4.63			0.00	2.31	1.12	2.15	0.22	0.87			
Total Loans & Advances	4.55		7.91			7.24			3.02	3.69	3.25	2.78	1.05	1.96			
Interest Income	0.55		1.11			0.64			0.22	0.55	0.66	0.41	0.16	0.27			
Investment & Fee Income	0.11		0.22			0.78			0.23	0.14		0.08	0.05	0.06			
Operating Expense	0.08		1.00			0.11			0.03	0.57	0.05	0.06	0.03	0.04			
Net Profit	0.11		0.27			0.68			0.21	0.12	0.08	0.14	0.09	0.06			
Financial Health																	
Capital Adequacy Ratio (%)												25.74%					
Advance to Deposits (%)	195.28%		127.79%			156.37%				160.00%	290.18%	129.30%		225.29%			
Med/Long Term Deposit Ratio (%)	50.09%		20.89%			49.27%				3.35%		57.01%		6.63%			
Med/Long Term Loan Ratio (%)	66.89%		75.57%			43.41%				54.11%		4.78%		60.46%			
Non-Performing Loans (%)	27.15%		2.49%			7.03%								11.46%			
Maturity Matching (%)	159.6%		203.5%			84.7%				152.61%		112.9%		174.23%			
Profitability																	
Return on Assets (%)	1.74%		1.29%			8.89%				2.82%	2.42%	4.45%		2.77%			
Return on Equity (%)	6.18%		19.19%			65.96%				24.47%	19.08%	31.68%		17.65%			
Ave Yield on Loans & Advances (%)																	
Ave Cost of Deposit (%)																	
Cost of Funds (%)	11.58%					11.25%								12.64%			
Operating Cost (%)																	
Net Interest Margin (%)																	
Efficiency																	
No. of Branches			6			3				1	3			1			
No. of Employees	62		116			63						87		24			
Ave Loan Bal/Employee (Tk thousand)	73,387.10		68,189.66			114,920.63						31,954.02		81,666.67			
Net Profit/Employee (Tk thousand)	1,774.19		2,327.59			10,793.65						1,609.20		2,500.00			
							HO in Oman										
Med/long term Deposit (A)	1.2		1.3			2.3			0.0	0.1	0.0	1.2	0.0	0.1			
Med/long term Loan (B)	3.0		6.0			3.1			0.0	2.0	0.0	0.1	0.0	1.2			
(A)-(B)	-1.9		-4.7			-0.9			0.0	-1.9	0.0	1.1	0.0	-1.1			
Sum of ((A)-(B)) if ((A)-(B))<0)	-1.9		-4.7			-0.9			0.0	-1.9	0.0	0.0	0.0	-1.1			

Note: =2008

	United Ls	IDLC	Intl Ls	Delta Brac	Lanka-B	People's Ls	Natl Hs	First Ls	Ban Fin	IIDFC	Uttara Fin	MIDAS Fin	Ave	
Balance Sheet & Income Statement														
Paid-up Capital				0.35			0.52	0.23				0.35	0.41	Paid-up Capital
Net Worth				0.51			0.74	0.65				0.49	0.76	Net Worth
Total Deposits				10.56			2.38	0.39				0.03	2.55	Total Deposits
Total Loans & Advances				12.18			3.57	1.33				0.69	4.09	Total Loans & Advances
Interest Income				1.87			0.66	0.21				0.30	0.59	Interest Income
Investment & Fee Income				0.09			0.02	0.03				0.04	0.15	Investment & Fee Income
Operating Expense				1.47			0.05	0.02				0.23	0.29	Operating Expense
Net Profit				0.23			0.10	0.10				0.07	0.17	Net Profit
Financial Health														
Capital Adequacy Ratio (%)													25.74%	Capital Adequacy Ratio 8%)
Advance to Deposits (%)				115.34%									174.94%	Advance to Deposits (%)
Med/Long Term Deposit Ratio (%)				17.36%									29.23%	Med/Long Term Deposit Ratio (%)
Med/Long Term Loan Ratio (%)													50.87%	Med/Long Term Loan Ratio (%)
Non-Performing Loans (%)				0.06%									9.64%	Non-Performing Loans (%)
Maturity Matching (%)													147.94%	Maturity Matching (%)
Profitability														
Return on Assets (%)													3.48%	Return on Assets (%)
Return on Equity (%)				45.34%								22.00%	27.95%	Return on Equity (%)
Ave Yield on Loans & Advances (%)														Ave Yield on Loans & Advances (%)
Ave Cost of Deposit (%)														Ave Cost of Deposit (%)
Cost of Funds (%)													11.82%	Cost of Funds (%)
Operating Cost (%)														Operating Cost (%)
Net Interest Margin (%)														Net Interest Margin (%)
Efficiency														
No. of Branches				6								4	3	No. of Branches
No. of Employees													70	No. of Employees
Ave Loan Bal/Employee (Tk thousand)													74,024	Ave Loan Bal/Employee (Tk thousand)
Net Profit/Employee (Tk thousand)													3,801	Net Profit/Employee (Tk thousand)
													Total	**Count**
Med/long term Deposit (A)				1.8			0.0	0.0				0.0	7.9	13
Med/long term Loan (B)				0.0			0.0	0.0				0.0	15.5	
(A)-(B)				1.8			0.0	0.0				0.0		if negative
Sum of ((A)-(B)) if ((A)-(B))<0)				0.0			0.0	0.0				0.0	-10.5	5

Note:
Cost of Funds = interest expense/average borrowing & deposits
Net Interest Margin = net interest income/average earning assets
Maturity Matching = total assets whose maturity exceeds one year excluding premises, fixtures and furniture divided by total liabilities of maturity longer than one year.

Table A4- 6: Extent of maturity mismatch

Type	Total number of institutions	Total number of institutions where financial documents (FY 2008 or 2009) have been collected	Loans and Advances of Residual Maturity Exceeding One Year (Tk billion)	Deposits of Residual Maturity Exceeding One Year (Tk billion)	Sum of absolute values of amounts of loans and advances over deposits of residual maturity exceeding one year (Tk billion)	Total number of institutions where maturity mismatch has been observed
SCBs	4	4	266.6	499.8	0.0	0
SBs	4	3	7.2	5.7	1.5	1
PCBs	30	27	491.1	439.0	108.7	14
FCBs	9	2	16.6	18.3	0.9	1
NBFIs	29	13	15.5	7.9	10.5	5
Total	76	49	797.0	970.7	121.6	21

Source: JICA Survey Team based on annual reports from financial institutions
Note 1: Financial documents referred are either FY 2008 or FY 2009.
Note 2: Although financial documents have been obtained, not all financial institutions provide detailed information on maturity structure.

Annex 5: Refinance scheme of BB

BB introduced the refinance schemes for SMEs in May 2004 using three sources of funds: BB's own resources, IDA under the Enterprise Growth and Bank Modernization Project (EGBMP) and ADB. Under the BB refinance scheme for the small enterprise sector, any industry/business entity having maximum fixed assets not exceeding Tk 10 Million has been considered as a small enterprise. Table A5- 1 summarizes the results of the three programs as of August 2007 and Tables Table A5- 3 and Table A5- 4 describe the results of the ADB-assisted program as of January 2009.

There are a number of features we can observe from the on-going refinance programs at BB.

(1) There are 13 banks (27.1%) out of 48 scheduled banks and 19 (65.5%) out to 29 NBFIs participating in the program.

(2) According to Table A5- 1, the total disbursement by banks amounts to Tk 2,741.8 Million with 4,340 SMEs and that by NBFIs to Tk 2,599.1 Million with 1,919 SMEs. The average amount refinanced per enterprise is Tk 0.63 Million in case of banks and Tk 1.35 Million in case of NBFIs.

(3) According to Table A5- 1, out of the total amount disbursed, 45% is classified into medium term loans and the rest of the amount is equally divided into working capital and long-term loans. In terms of the type of financial institutions, banks tend to extend shorter term loans as loans with tenor up to 3 years account for 97% of the total amount disbursed by banks. On the other hand, NBFIs are inclined to extend more longer-term loans with 55 % of the total disbursement being classified into long-term loans.

Table A5- 1: Summary of results of the refinance program by BB as of August 2007

Unit: Tk Million

	Working capital (up to 1 year)	Medium-term (up to 3 years)	Long-term (up to 5 years)	Total
Banks	1,318.66	1,333.33	89.81	2,741.80
Share	48%	49%	3%	100%
NBFIs	116.82	1,061.71	1,420.61	2,599.14
share	4%	41%	55%	100%
Total	1,435.48	2,395.04	1,510.42	5,340.94
share	27%	45%	28%	100%

(4). Table A5- 4, which specifically shows the results of the ADB-assisted project as of January 2009, also shows a similar tendency in terms of the distribution of loans by tenor. It also shows the sector-wise distribution of disbursement. The trade sector accounts for 52 % of the total disbursement and 62% of the number of beneficiary enterprises while the industrial (manufacturing) sector shows 27% in terms of both disbursement and the number of enterprises. In particular, commercial banks extend 65% of the funds to the trade sector. It is noted that NBFIs provided 47% of the fund to the service sector.

Table A5- 2: SME Refinance by BB

	Aug. 2007	amount of refinanced (million Tk)					
Name of PFI	BB refinance scheme	working capital	mid-term	long-term	total	no. of beneficiary enterprises	amount refinanced per enterprises(million Tk)
Commercial Banks							
BRAC Bank limited	X	48.65	637.80	0.00	686.45	1,736	0.40
Dhaka Bank limited	X	268.61	123.35	0.00	391.96	476	0.82
Eastern Bank Limited	X	112.61	190.56	0.00	303.17	392	0.77
One Bank limited	X	150.55	127.63	10.40	288.58	382	0.76
The Premier Bank Limited	X	208.29	24.54	9.35	242.18	205	1.18
National Credit and Commerce Bank	X	21.64	155.05	52.00	228.69	548	0.42
Prime Bank Limited	X	179.72	10.72	6.90	197.34	211	0.94
Jamuna Bank Ltd.	X	136.40	24.90	7.66	168.96	121	1.40
Dutch Bangla Bank Ltd.	X	95.99	1.33	0.00	97.32	52	1.87
Southeast Bank Ltd.	X	81.20	3.20	3.50	87.90	86	1.02
Mercantile Bank Limited	X	0.00	34.25	0.00	34.25	127	0.27
National Bank Ltd.	X	10.00	0.00	0.00	10.00	2	5.00
Trust Bank Limited	X	5.00	0.00	0.00	5.00	2	2.50
Total Commercial Bank Refinancing	13	1,318.66	1,333.33	89.81	2,741.80	4,340	0.63
share		48%	49%	3%	100%		
Non-Bank Financial Institutions							
Midas Financing Limited	X	0.05	283.00	154.82	437.87	684	0.64
Uttara Finance and Investment Co.	X	8.76	95.75	332.41	436.92	234	1.87
United Leasing Company Ltd	X	47.03	115.75	136.03	298.81	191	1.56
Peoples leasing and Financial Services Ltd.	X	0.00	116.41	181.83	298.24	110	2.71
Industrial Development Leasing Company	X	7.75	215.03	70.05	292.83	211	1.39
Fidelity Assets and Security Services Limited	X	0.00	7.17	196.57	203.74	132	1.54
Phoenix Leasing Co.Ltd.	X	10.10	39.08	138.65	187.83	101	1.86
Islamic Finance and Investment ltd	X	6.10	104.31	23.25	133.66	107	1.25
Industrial and Infrastructure Development Finance Company Limited	X	2.00	23.20	35.10	60.30	29	2.08

	Aug. 2007	amount of refinanced (million Tk)					
Name of PFI	BB refinance scheme	working capital	mid-term	long-term	total	no. of beneficiary enterprises	amount refinanced per enterprises(million Tk)
Prime Finance & Investment Ltd.	X	22.50	19.00	12.84	54.34	30	1.81
Bangladesh Finance and Investment Ltd.	X	0.00	1.68	40.90	42.58	18	2.37
Oman Bangladesh	X	0.00	0.00	40.84	40.84	19	2.15
International Leasing and Finance Services	X	1.00	17.80	19.72	38.52	16	2.41
GSP Finance Bangladesh Limited	X	5.00	0.00	20.80	25.80	6	4.30
National Housing Finance and Investment Ltd	X	4.00	7.60	9.14	20.74	12	1.73
Premier Leasing International Ltd	X	0.00	9.40	2.96	12.36	7	1.77
Bay Leasing and Investment Ltd.	X	2.50	5.15	4.70	12.35	8	1.54
Fareast Finance and Investment Ltd.	X	0.00	1.33	0.00	1.33	2	0.67
Vanik Bangladesh Ltd.	X	0.03	0.05	0.00	0.08	2	0.04
Total Non-Bank Financial Institutions	19	116.82	1,061.71	1,420.61	2,599.14	1,919	1.35
share		4%	41%	55%	100%		
Grand Total of Refinancing	**32**	**1,435.48**	**2,395.04**	**1,510.42**	**5,340.94**	**6,259**	**0.85**
share		**27%**	**45%**	**28%**	**100%**		

Source: PAU, Institutional Lending and Financing Policy for SMEs in Bangladesh, Policy Note Series: PN 0804, Dec. 2007

Table A5- 3: Refinance program by ADB

Name of PFI	Jan. 2009	
	ADB PFIs	Applied for ADB program
Commercial Banks		
BRAC Bank limited	x	
Dhaka Bank limited	x	x
Eastern Bank Limited	x	x
One Bank limited	x	x
The Premier Bank Limited	x	
National Credit and Commerce Bank	x	x
Prime Bank Limited	x	x
Mercantile Bank Limited	x	
Trust Bank Limited	x	x
BASIC Bank Limited	x	
Bank Asia Limited	x	x
The City Bank Limited	x	x
Total Commercial Bank Refinancing	12	8
Non-Bank Financial Institutions		
Midas Financing Limited	x	x
Uttara Finance and Investment Co.	x	x
United Leasing Company Ltd	x	
Peoples leasing and Financial Services Ltd.	x	x
Industrial Development Leasing Company	x	x
Fidelity Assets and Security Services Limited	x	
Islamic Finance and Investment ltd	x	x
Industrial and Infrastructure Development Finance Company Limited	x	
Bangladesh Finance and Investment Ltd.	x	
International Leasing and Finance Services	x	x
GSP Finance Bangladesh Limited	x	
National Housing Finance and Investment Ltd	x	
Premier Leasing International Ltd	x	x
Bay Leasing and Investment Ltd.	x	
Bangladesh Industrial Finance Company Ltd	x	
Total Non-Bank Financial Institutions	14	7
Grand Total of Refinancing	**26**	**15**

Table A5- 4: Results of the ADB refinance program as of Jan 2009

Item	Name of PFI	Total Commercial Bank Refinancing	share	Total Non-Bank Financial Institutions	share	Grand Total of Refinancing	share
Basic features	No of PFIs accredited	12		14		26	
	No. of PFIs which actually applied for ADB program	8		7		15	
	Availed funds from the program (Tk Million)	2,043		514 (Note)		2,557	
Availed fund by tenor	short-term	1,157	57%	52	5%	1,209	38%
	mid-term	667	33%	606	53%	1,273	40%
	long-term	219	11%	476	42%	695	22%
	Total	2,043	100%	1,134	100%	3,177	100%
Industry (Manufacturing)	Availed funds (Tk Million)	544	27%	300	28%	844	27%
	no. of beneficiary enterprises	513	24%	215	34%	728	27%
	amount refinanced per enterprise (million Tk)	1.06		1.40		1.16	
Trade	Availed funds (Tk Million)	1,334	65%	273	25%	1,606	52%
	no. of beneficiary enterprises	1,448	69%	252	39%	1,700	62%
	amount refinanced per enterprise (million Tk)	0.92		1.08		0.94	
Services	Availed funds (Tk Million)	165	8%	499	47%	664	21%
	no. of beneficiary enterprises	134	6%	172	27%	306	11%
	amount refinanced per enterprise (million Tk)	1.23		2.90		2.17	
Total	Availed funds (Tk Million)	2,043	100%	1,071	100%	3,114	100%
	total no. of beneficiary enterprises	2,095	100%	639	100%	2,734	100%
	amount refinanced per enterprise (million Tk)	0.98		1.68		1.14	

Source: ADB, Technical Assistance Consultant’s Report: Bangladesh: Small and Medium Enterprise Sector Development Program, May 2009.
Note: The total of amount refinanced to NBFIs does not tally with the total amount classified by tenor and sector.

Annex 6: Average land value per firm

The following table shows the average land value per firm. Enterprises may own and or rent factory premises. The values in the table presumably represent both cases, but the average land value could indicate the relative ease in accessing loans as the JICA Survey Team came across a case where a bank uses a rental agreement as collateral when borrowers (renters) put advance deposits to landlords. As seen from the table, in most business types, SMEs and micro enterprises do not have sufficient land to use as collateral.

Table A6- 1: Average land value per firm (Tk million)

Firm size classes	Agro processing	Basic metallic	Electrical	Furniture making	Knitwear	Leather	Light engineering
Micro	2.2	1.0	0.1	3.1	0.0	0.0	2.4
Small	8.2	624.7	0.1	9.5	0.3	9.5	11.3
Medium	67.5	5,005.5	0.0	7.7	0.2	4.9	14.6
Large	3,322.0	40.4	0.1	34.3	34.9	31.1	33.9
All	179.0	532.7	61.6	8.8	14.8	9.0	13.8

Firm size classes	Medical, optical equipments	Motor vehicle products	Non metallic minerals	Other transport	Paper and paper based goods	Parts and Components	Designer goods
Micro	0.0	0.0	7.5	14.3	0.0	0.3	1.1
Small	0.0	15.0	11.4	4.1	1.3	1.2	3.1
Medium	0.0	27.5	10.0	2.6	0.0	2.5	2.3
Large	165.0	50.0	21.4	4.5	51.3	56.3	106.0
All	165.0	30.0	19.0	8.6	2.2	2.1	7.4

Firm size classes	Pharmaceuticals	Plastic	Printing and Publishing	Radio, television	Tobacco	Wood cork and Wood products
Micro	5.4	0.5	17.4	0.0	0.1	6.2
Small	11.4	3.3	70.9	31.3	3.1	1.4
Medium	29.9	8.9	20.0	0.0	10.0	0.0
Large	3,145.3	121.5	135.0	0.0	114.3	0.0
All	953.7	16.6	58.8	31.3	67.0	3.7

Source: Towards an Evidence Base for Efficient, Proactive and Inclusive SME Development: National-wide sample survey 2007/2008 (Data has been provided through the courtesy of Dr. Naeem Chowdhury, Maxwell Stamp Limited)

Note 1: The following criteria have been applied for the definitions of size of firms: micro for headcounts up to 9; small for headcounts between 10 and 49; medium for headcounts between 50 and 99; and large for headcounts over 100. This definition follows a former definition provided by BSS.

Note 2: Some business types, a sample size of large scale enterprises is very small and it may not form an appropriate base for statistical inference.

Annex 7: Comparison of specific features of refinance schemes with the proposed project

The following table compares the specific features of the scheme

The total amount of funds for existing refinance schemes is calculated at Tk 14,540 million. With the addition of the JICA loan, the total amount is expected to increase to Tk 18,290 million.

Table A7- 1: Comparison of existing refinance schemes and proposed JICA project

Item	BB' SEF	IDA EGBMP	ADB SMESDP 1	ADB SMESDP 2	Proposed JICA Project
1. Amount supported by donors/GoB	Tk 6,000 million	Tk 1,160 million as of 2009 (USD 10 million from IDA and Tk 0.58 billion from GoB)	USD 30 million (= Tk 2,020 million)	USD 76 million (=Tk 6,600 million)	
2. Amount refinanced as of Dec. 2009 including those from revolving fund	Tk 8,532 million	Tk 2,441 million	Tk 3,349 million	Yet to be started at the time of JICA survey	
3. Target area/sector	Not specified	No restriction on sectors/regions	Not specified	Outside Dhaka and Chittagong metropolitan areas Preference for underdeveloped areas and priority sectors as outlined in the industrial policy	No restriction on sectors/regions
4. Number of PFIs	18 banks 21 non-bank financial Institutions	17 banks 23 non-bank financial Institutions	13 banks 15 non-bank financial institutions		
5. Eligibility criteria of SMEs	Enterprises having fixed assets not exceeding Tk 10 million	Both existing and new enterprises Enterprises having fixed assets not exceeding Tk 10 million	Both existing and new enterprises Enterprises having fixed assets not exceeding Tk 10 million	Both existing and new enterprises Fixed asses not exceeding Tk 200 million (excluding land and building)	Both existing and new enterprises Fixed asses not exceeding Tk 200 million (excluding land and building)
6. Number of Beneficiary enterprises as of Dec. 2009	8,317	2,541	3,264		
7. Size of sub-loans	Tk 0.2 million to Tk 5.0 million	Tk 0.2 million to Tk 5.0 million For women entrepreneurs: Tk 0.1 million to Tk 5.0 million	Tk 0.2 million to Tk 5.0 million	Up to Tk 7 .0 million	Tk 0.5 million to Tk 30.0 million (to be coincided)
8. Financing structure of sub-project	Not specified	Not specified	Not specified	Not more than 75% (at least 15% from PFI and 10% from SME)	Not more than 75% (at least 15% from PFI and 10% from SME)
9. Use of sub-loans	Not specified	(1) Fixed assets (including machinery, equipment, factory buildings, related civil works), technical know-how, consultancy services and training (2) Working capital (including initial stocks or increases in stocks of raw materials, spare parts and components) (3) Leasing of industrial and business equipment	(1) Fixed assets (including machinery, equipment, factory buildings and related civil works), technical know-how, consultancy services and training (2) Working capital (including initial stocks or increases in stocks of raw materials, spare parts and components) (3) Leasing of industrial and business equipment	Cost of goods (equipment and materials including related services such as transportation, insurance, installation, commissioning, training, and initial maintenance), works (construction or civil works including services such as drilling or mapping, and Project related services that are provided as part of a single responsibility or turnkey contract) and consulting services required to carry out the qualified subproject	(1) Fixed assets (including machinery, equipment, factory buildings and related civil works), technical know-how, consultancy services and training (2) Initial working capital (including initial stocks of raw materials, spare parts and components) (3) Leasing of industrial and business equipment

Item	BB' SEF	IDA EGBMP	ADB SMESDP 1	ADB SMESDP 2	Proposed JICA Project
10. Repayment period of sub-loans (S)=Short-term (M)=Medium-term (L)=Long-term	(S) Max 1 year (M) Max 3 years (6 month grace) (L) Max 5 years (6 month grace)	(S) 1 year (M) Over 1 year to 4 years (6 month grace) (L) Over 4 years to 5 years (1 year grace)	(S) 1 year (M) Over 1 year to 3 years (6 month grace) (L) Over 3 years to 5 years (1 year grace)	Not less than 2 years	2 to 8 years In case of working capital, initial one year that is renewable up to 5 years based on actual results of production and sales
11. Interest rate of sub-loans to SME	PFI's own interest rate	PFI's own interest rate	PFI's own interest rate	Rates that reflect PFIs' cost of funds plus a spread that covers transaction costs and risk adjusted returns	PFI's own interest rate
12. Interest rate to PFI	Bank rate	Bank rate	Bank rate	Bank rate	Bank rate
13. Financing method	Refinancing	Refinancing	Refinancing	Refinancing	Mixture of refinancing and pre-financing
14. NPL criteria of PFI	No more than 10% classified loans on portfolios up to Tk 5.0 million	No more than 10% classified loans on portfolios up to Tk 5.0 million	No more than 10% classified loans on portfolios up to Tk 5.0 million	Not mentioned	No more than 10% classified loans on portfolios of small loans and entire portfolio
15. Employment of consultant for loan administration	No	No	No	No	Yes
16. Women enterprises	Not mentioned	Not mentioned	Encourage women entrepreneurs to use lending facilities	Earmark a minimum of 15% of sub-loans for lending to women entrepreneurs but in the event these funds are not utilized within a period of 2 years from the effective date, such funds shall revert to the general pool.	Not applied
17.Remarks		Maximum ceiling of sub-loans Tk 5.0 million is set to cater for the "missing middle" of entrepreneurs	The project loan will be provided to enhance access to credit by SMEs, especially small enterprises referred to as the "missing middle."		

Annex 8: Study on the credit guarantee scheme

(1) Background

Most SMEs meet their financial needs from internal and informal sources instead of relying on external financing. Limited access to external financing has posed constraints on SMEs in expanding their business or even running regular business operations in a competitive business environment. Among others, the insufficiency of adequate collateral is one of the big constraints that SMEs face when they apply for loans from lending institutions as necessary collateral is the key tool needed for reducing credit risk on the side of the lending institutions. The credit guarantee system has been considered a potential tool in mitigating collateral issues by shifting from collateral based or security oriented lending to project based lending. However, in-depth study will be required in order to examine the feasibility of the scheme in the country as it may possibly generate moral hazard of financial institutions and borrowers.

(2) Concept paper on the formation of the credit guarantee scheme prepared by the SME Foundation

The SME Foundation worked on a concept paper on the formation of the credit guarantee scheme. The concept paper shows the following specific features of the proposed credit guarantee scheme:

- Fund to be set up through the joint initiatives of MOF/MOI, BB and SMEF in association with other government owned institutions like Sonali Bank Ltd., Janata Bank Ltd., ICB, Sadharan Bima Corporation,[1] etc. SMEF can take the lead role. Beneficiary financial institutions can be also involved in the formation of the scheme.
- The scheme is to be administrated by a separate and independent organization established under the company act 1995 as a “not for profit organization.” It could otherwise be a separate authority, established through a law passed in Parliament.
- The guarantee scheme may however be an organization in the part ownership of SMEF. Other organizations like the Sonali Bank, Sadharan Bima Corp., BASIC Bank, ICB, etc. may be other partners. The foundation can earn money from the said ownership.

Figure A8- 1 on the following page shows the overall structure of the proposed scheme as the JICA Survey Team understands it from the concept paper.

The important issues to be discussed with regard to the scheme are: (1) the level of premium in order to run the scheme in a sustainable way; (2) feasibility of securing the guarantee fund and the possibility of expanding it on a larger scale; and (3) the feasibility of the legal and institutional set-up required for the insurance scheme. With respect to point (2) above, the initiative as well as the commitment of MOI will be considered to be crucial.

[1] Sadharan Bima Corporation is a wholly state-owned General Insurance Corporation operating under the direct control and supervision of the Ministry of Commerce. It emerged on 14th May, 1973 under the Insurance Corporation Act (Act No. VI) of 1973 to deal with all classes of the general insurance & re-insurance business emanating in Bangladesh (http://www.sbc.gov.bd/).

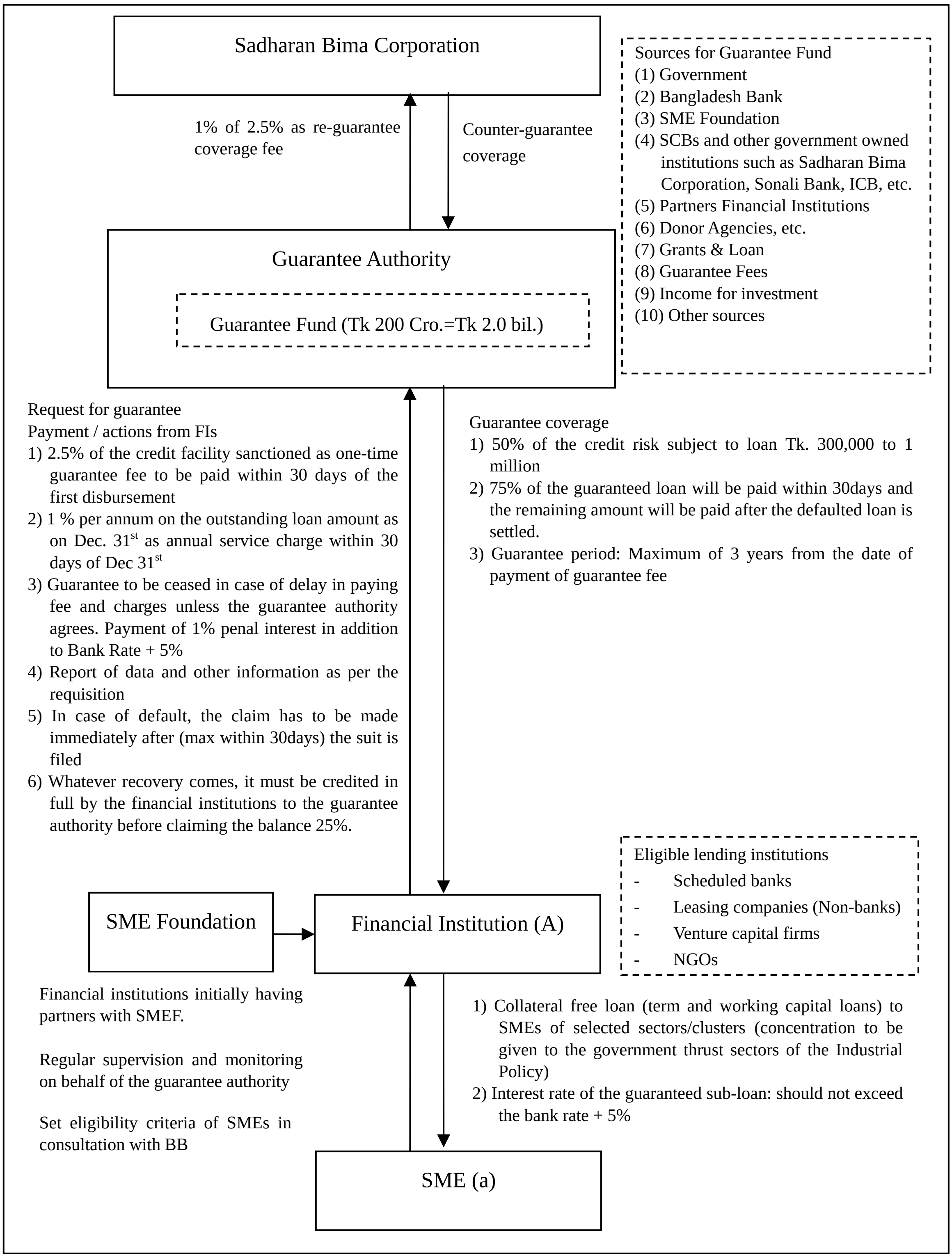


Figure A8- 1: Credit Guarantee Scheme based on the concept paper prepared by SMEF

Possible chairperson and members of the trustee board of the Guarantee Authority

(1) Bangladesh Bank
(2) Ministry of Finance
(3) Ministry of Industries
(4) Sadharan Bima Corporation (State-owned insurance company)
(5) Investment Corporation of Bangladesh (ICB)
(6) SME Foundation
(7) Bankers Association of Bangladesh (BAB)
(8) Federation of Bangladesh Chambers of Commerce and Industry (FBCCI)
(9) Professionals
(10) Women entrepreneurs
(11) Proposed Guarantee Scheme Authority

Figure A8- 2 below has been prepared to discuss and clarify features described in Figure A8- 1. One of the differences between Figure A8- 1 and Figure A8- 2 is the role of SMEs in the scheme. In Figure A8- 2, SMEs will deal with the Guarantee Authority either directly or indirectly through financial institutions. SME Foundation will play a limited role, and Sadharan Bima Corporation (State-owned insurance company) will be also excluded from the trustee board of the Guarantee Authority to avoid conflicts of interests.

Possible chairperson and members of the trustee board of the Guarantee Authority under Figure A8- 2.

(1) Bangladesh Bank
(2) Ministry of Finance
(3) Ministry of Industries
(4) Investment Corporation of Bangladesh (ICB)
(5) SME Foundation
(6) Bankers Association of Bangladesh (BAB)
(7) Federation of Bangladesh Chambers of Commerce and Industry (FBCCI)
(8) Professionals
(9) Women entrepreneurs
(10) Proposed Guarantee Scheme Authority

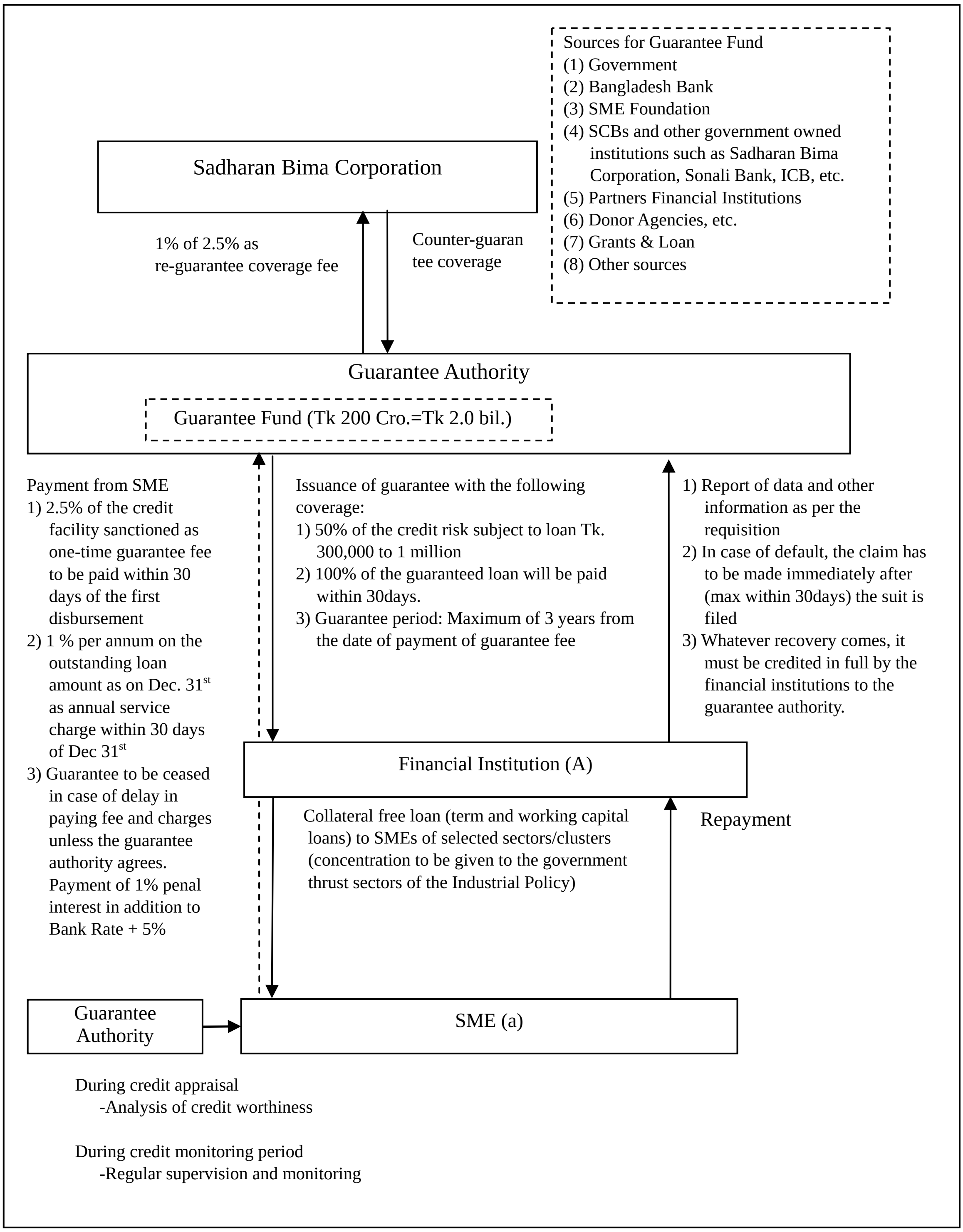


Figure A8- 2: Alternative scheme

Annex 9: Four categories of industries and enterprises

In acquiring the Environmental Clearance Certificate (ECC) which is the environmental approval for the location and the implementation of industries and enterprises, the target industries and enterprises shall be classified into four categories (Green, Orange-A, Orange-B, Red)

Green category
1. Assembly and manufacturing of TV and radio
2. assembly and manufacturing of clocks and watches
3. assembly of telephones
4. assembly and manufacturing of toys (excluding plastic items)
5. book-binding
6. ropes and mats (made of cotton, jute and artificial fiber)
7. photography (excluding film and x-ray)
8. manufacturing of artificial leather goods
9. assembly of motorcycles, bicycles and toy cycles I
10. assembly of scientific and mathematical instruments (no manufacturing)
11. musical instruments
12. sports goods (excluding plastic ones)
13. tea packing (no manufacturing)
14. re-packing of powdered milk (no manufacturing)
15. bamboo and cane goods
16. artificial flowers (excluding plastic ones)
17. fountain and ball pens
18. jewelry shops (without manufacturing)
19. candles
20. medical and surgical appliances (without manufacturing)
21. factories manufacturing cork items (excluding metallic ones)
22. laundry (without washing)

Orange-A category
1. dairy (in urban areas 10 or below and in rural areas 25 or below)
2. poultry (in urban areas a maximum of 250 and 1000 in rural areas)
3. grinding/husking of wheat, rice, turmeric, pepper, pulses (up to 20 horse power)
4. weaving and handlooms
5. production of shoes and leather foods (investment up to Tk. 5 lacs)
6. sawmills
7. furniture of wood, iron, alu8minum etc. (investment up to Tk. 5 lacs)
8. printing presses
9. plastic and rubber foods (excluding PVC)
10. restaurants
11. carton/ box manufacturing/ printing packaging
12. cinema halls
13. dry cleaning
14. manufacturing of artificial leather foods (investment up to Tk. 5 lacs)
15. sports equipment and appliances
16. salt production (investment up to Tk.19 lacs)

Orange-A category
17. agricultural machinery and equipment 18. industrial machinery, tools and equipment 19. jewelry/ gold ornament manufacturing 20. al pin and U-pin 21. frames of spectacles 22. combs 23. brass and bronze utensils and souvenirs manufacturing 24. biscuit and bread factory (investment up to Tk. 5 lacs) 25. chocolate and lozenge manufacturing factory (investment up to Tk. 5 lacs) 26. wooden water vessel manufacturing

Orange-B category
1. PVC items 2. artificial fiber (raw material) 3. glass factory 4. life saving medicines (only formulation) 5. edible oil 6. coal tar 7. jute mills 8. hotel, multi-storied commercial and apartment building 9. casting and molding 10. aluminum goods 11. adhesives (excluding animal glue) 12. bricks / tiles 13. lime 14. plastic goods 15. bottled drinking water, soft carbonated drinks manufacturing and bottling 16. galvanizing 17. perfume, cosmetics 18. flour (large) 19. carbon rods 20. stone grinding, cutting and polishing 21. fish, meat and food processing 22. printing and writing ink 23. animal food 24. ice cream 25. clinic and pathological labs 26. utensils made of clay and china clay / sanitary wares (ceramics) 27. processing of prawns/shrimps 28. water treatment plants 29. metallic utensils / cutlery etc. 30. sodium silicate 31. matches 32. starch and glucose 33. food for domestic animals 34. automatic rice mills

Orange-B category
35. assembly of motor vehicles 36. wooden water vessel manufacturing 37. photography (activities related to movie and x-ray film manufacturing) 38. tea processing 39. powdered milk manufacturing/condensed milk/dairy 40. re-rolling 41. wood processing 42. soap 43. repairing of refrigerators 44. repairing of metallic water vessels 45. engineering works 8up to Tk. 10 lacs) 46. yarn manufacturing (spinning mill) 47. electric cables 48. cold storage 49. tire re-treading 50. repairing works for motor vehicles (investment up to Tk. 10 lacs) 51. cow farms (more than 10 in urban area and 25 in rural area) 52. poultry (chicken more than 250 in urban area and 1000 in rural area) 53. flour, rice, turmeric, pepper, pulse grinding (capacity more than 20 HP) 54. shoe and leather goods manufacturing (capital above Tk. 5 lacs) 55. furniture of wood, iron aluminum (capital above Tk. 5 lacs) 56. artificial leather goods manufacturing (capital above Tk. 5 lacs) 57. salt processing (capital above Tk. 10 lacs) 58. biscuit and bread factory (capacity up to Tk. 5 lacs) 59. chocolate and lozenge factory (capital up to Tk. 5 lacs) 60. garment and sweater manufacturing 61. garments/fabric washing 62. power looms 63. road construction/reconstruction/extension (feeder roads, local roads) 64. bridge construction/reconstruction/extension (length below 100m) 65. public toilets 66. ship breaking 67. G.1 wires 68. assembly of batteries 69. dairy and food

RED category
1. leather processing (tannery) 2. formaldehyde 3. urea-fertilizer 4. T.S.P. fertilizer 5. chemical dyes, polishes, varnish and enamels 6. power plants 7. all mining projects (coal, limestone, hard rock, natural gas, mineral oil etc.) 8. cement 9. fuel oil refineries

RED category
10. artificial rubber 11. paper and pulp 12. sugar 13. distilleries 14. fabric dyeing and chemical processing 15. caustic soda, potash 16. other alkalis 17. iron and steel manufacturing 18. raw materials for medicine and basic drugs 19. electroplating 20. photo films, photo paper and photo chemicals 21. chemicals derived from petroleum or coal 22. explosives 23. acids and their salts (organic and inorganic) 24. Nitrogen compounds (cyanide, cyanide etc.) 25. production of plastic raw materials (PVC, PP/iron, polystyrene etc.) 26. asbestos 27. fiber glass 28. pesticides, fungicides and herbicides 29. phosphorus and its compounds/derivatives 30. chlorine, fluorine, bromine, iodine and their compounds/derivatives 31. industrial gases (excluding nitrogen, oxygen and carbon dioxide) 32. waste incinerators 33. other chemicals 34. ordinance factories 35. nuclear power 36. alcoholic beverages 37. non-metallic chemicals not listed elsewhere 38. non-metals not listed elsewhere 39. industrial estates 40. basic industrial chemicals 41. basic metals not related to iron 42. detergents 43. land filling by municipal/ industrial/ commercial waste 44. sewage treatment plants 45. life saving drugs 46. animal glue 47. rodenticide 48. refractories 49. industrial gas (nitrogen, oxygen,. Carbon-dioxide) 50. batteries 51. hospitals 52. ship manufacturing 53. tobacco (processing/ cigarette/ bin-making) 54. metallic boat manufacturing 55. wooden boat manufacturing

RED category
56. refrigerators, air conditioner/air cooler manufacturing 57. tires and tubes 58. board mills 59. carpets 60. engineering works (capital above Tk. 10 lacs) 61. repairing of moor vehicles (capital above Tk. 10 lacs) 62. water treatment plants 63. laying down/replacement/expansion of sewerage pipelines 64. laying down/replacement/expansion of water, power and gas distribution lines 65. exploration/extraction/distribution of mineral resources 66. construction/reconstruction/expansion of flood control embankments, polders, dikes etc. 67. construction/reconstruction/expansion of roads (regional, national and international 68. construction/reconstruction/expansion of bridges (length 200m or above) 69. Murate of Potash (manufacturing)

Annex 10: List of key persons contacted during the Survey

Division/Dept Organization	Key persons contacted	Position
Economic Relations Division Ministry of Finance	Mr. Mohammad Shafiqul Azam	Additional Secretary
Bank & Financial Institution Division, Ministry of Finance	Mr. Md. Shahid Ulla Mia	Joint Secretary
Finance Division, Ministry of Finance	Mr. Amolendu Mukharjee	Joint Secretary
Planning Division, Ministry of Planning	Mr. Habib Ullah Majumder	Secretary
General Economics Division, Planning Commission	Professor Shamsul Alam	Member
Ministry of Industries	Mr. Mohammad Altaf Husain	Deputy Secretary (SME)
Bangladesh Bank	Mr. Md. Nazrul Huda	Deputy Governor,
SME & Special Programme Department, Bangladesh Bank	Mr. Sukamal Sinha Chowdhury	General Manager
Small & Medium Enterprise Foundation	Mr. Syed Rezwanul Kabir	Managing Director,