

Overshadowed by the Umbrella of SMES



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Cottage and micro enterprises occupy a critical position in our national economy. Despite employing 20.3 million people, these businesses are poorly documented, unorganized, and underfunded. According to a 2013 census, 6.86 million cottage industries supported 13.16 million jobs, while 0.11 million micro industries supported 0.56 million jobs.[1] They constitute 99.97% of all non-farming SMEs.[2]

The real GDP of our country dropped to 5.24 percent in FY20 from 8.15 percent in FY19 due to COVID, but we were still in the top five of the fastest-growing developing economies according to the World Bank. The manufacturing sector comprising CMSMEs was the major growth driver. The 7.8 million CMSMEs contribute 25 percent to GDP, 11 percent of entire industries, 30 percent of industrial employment and 40 percent of the manufacturing output.[3] The MSME is one of the largest segments of the national economy, contributing 25 percent to GDP.[4]

Despite the huge number, these enterprises have been overshadowed by the umbrella of the 'SME sector' in national policy-making. Among the many grievances of Cottage, Micro, Small and Medium Enterprises (CMSME), insufficient access to finance is a prominent one. The MSMEs are limited financially with an estimated financing gap of 20 percent of GDP.[5]



[1] Ferdaus Ara Begum, 'Inclusion of cottage and micro enterprises into SME Policy' The Financial Express (7 February 2020) <www.thefinancialexpress.com.bd/views/inclusion-of-cottage-and-micro-enterprises-into-sme-policy-1580482776> accessed 18 May 2022

[1] Asian Development Bank, 'Asia Small and Medium-Sized Enterprise Monitor 2021: Volume I—Country and Regional Reviews' (Asian Development Bank, 2021) <www.adb.org/publications/asia-sme-monitor-2021-country-regional-reviews> accessed 18 May 2022

[1] Nasrin Akther Lubna, Md Abir Hossain and Md Ezazul Islam, 'Covid-19 fallout on CMSMEs -- an assessment of the policy responses' The Financial Express (6 July 2021) <<https://thefinancialexpress.com.bd/views/covid-19-fallout-on-cmsmes-an-assessment-of-the-policy-responses-1625583687>> accessed 18 May 2022

[1] LightCastle Analytics Wing, 'Digital Financial Services in Agriculture and MSME Sectors' (LightCastle Partners, 30 June 2021) <www.lightcastlebd.com/insights/2021/06/digital-financial-services-in-agriculture-and-msme-sectors/> accessed 18 May 2022

[1] United Nations ESCAP and UNCDF, 'Micro, Small and Medium-sized Enterprises' Access to Finance in Bangladesh' (United Nations, 2021) <www.unescap.org/sites/default/d8files/knowledge-products/MSME%20financing%20Bangladesh_10%20May%202021_share_0.pdf> accessed 18 May 2022

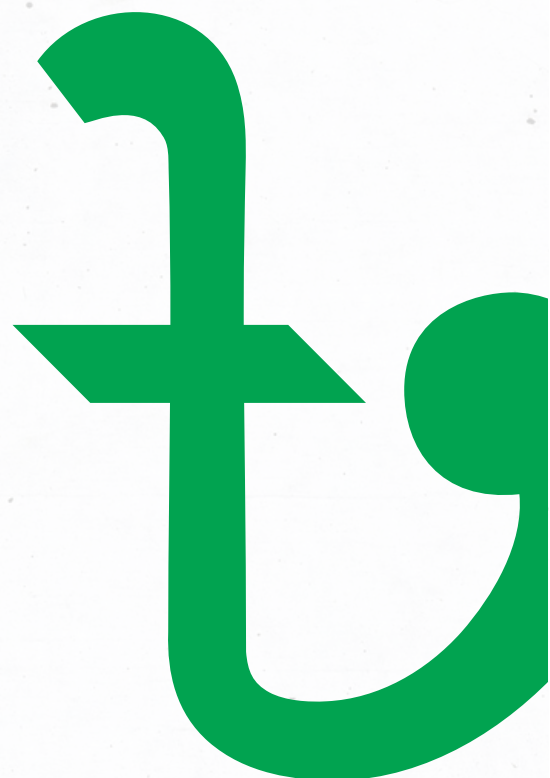


PRESENT LANDSCAPE OF FUNDING

CMSMEs in Bangladesh commonly avail loan banks, NBFIs, MFIs, and informal sources like relatives or local lenders. Banks are required to set up SME help desks and Women Entrepreneurship desks in all branches to increase access to credit for SMEs. Despite this, access to formal credit is low among SMEs. According to the World Bank, the SME sector in Bangladesh has a financing gap of \$2.8 billion.[6]

According to a 2013 census, more than 40% of SMEs did not have access to formal credit.[7] This number is supposed to be higher when we narrow it down to the cottage and micro enterprises.

Moreover, apart from some exceptions, the banks and NBFIs are not being successful in realizing the Bangladesh Bank's MSME financing goals. The current provision and equity products of banks are not suited to the needs of MSMEs. [8]



[6] The World Bank, 'Small and Medium Enterprises (SMEs) Finance' (The World Bank) <www.worldbank.org/en/topic/sme/finance> accessed 18 May 2022

[7] Alexander Ayertey Odonkor, 'How access to finance can multiply the growth of SMEs' The Business Standard (9 June 2021) <www.tbsnews.net/thoughts/how-access-finance-can-multiply-growth-smes-258010> accessed 18 May 2022

[8] United Nations ESCAP and UNCDF, (n 5)

Women Led Enterprises and The Role of MFIs

While access to finance remains a challenge for all CMSMEs, women are particularly more vulnerable to this. World Bank data shows that 60% of women-owned SMEs are denied access to formal sources of financing because of the lack of collateral.[9] A report by UNESCAP shows that cottage and micro-enterprises led by women, especially those in F-commerce, are less likely to have trade licences.

The tedious and complex process of obtaining documents has been shown as a plausible reason for the lack of formalisation of women-led enterprises. Gender-specific barriers like lack of subsidised childcare facilities and hardship in gaining land and property ownership also contribute to excluding women from gaining access to formal financing. The current supply-side provision is not tailored to the demand-side financial constraints faced by women-led enterprises.[10]



Women-led MSMEs have shown greater flexibility, more skill at contingency planning and greater resilience through adopting conservative business strategies. The enterprises are more likely to adjust operational activities like cost cutting, re-negotiating payment terms etc. These enterprises have been seen to do more philanthropic activities like giving products for free to Covid-19 impacted people.[11] According to a study by the Policy Research Institute of Bangladesh (PRI), women-led enterprises facilitated 146.2 percent employment growth.[12] Therefore, women-led enterprises need attention to tap into the future growth prospects.

[9] Alexander Ayertey Odonkor, (n 7)

[10] United Nations ESCAP and UNCDF, (n 5)

[11] United Nations ESCAP and MPI, 'Assessment of the Impact of COVID-19 on MSMEs, and especially women-led MSMEs in VietNam' (United Nations, 2020) <www.unescap.org/sites/default/d8files/2020-09/ESCAP_VietNam_MSMEs_and_COVID-19.pdf> accessed 18 May 2022

[12] Nasrin Akther Lubna, Md Abir Hossain and Md Ezazul Islam, (n 3)

Micro Finance Institutions (MFIs) have made progress in this regard. They have successfully extended credit to women entrepreneurs in rural and semi-urban areas. The source of the funds disbursed by MFIs has had a journey as well. MFIs have moved away from their dependence on donor funding and diversified into more sustainable sources like bank loans, accumulated surplus, and member bonds.

But credit from MFIs definitely comes at a higher cost for the borrowers. In fact, borrowing from MFIs is almost three times costlier than borrowing from banks or NBFIs. A concerning case is emerging about the size of loans disbursed by MFIs. The report by UNESCAP shows that 55% of MFI borrowers borrowed 'extra-large' loans, which amount to more than BDT 500,000. These extra-large borrowers would have qualified for loans from banks but access is likely to have been blocked because of their lack of formalisation. For them, the cost of non- formalization is MFI loans at soaring costs.

Problems in Classification and Clustering

The problem with CMSME financing in Bangladesh starts with the classification used for SME policy formulation. The government has divided the SME sector into the cottage, micro, small, and medium enterprises. Of these, the cottage enterprises are those that have a maximum of 15 employees, and medium enterprises can have up to 300. Among all the establishments, cottage industries are 87.52 percent, micro are 1.33 percent, small is 10.99 percent, medium is 0.09 percent and 0.07 percent are large.[13]

While there is a distinct classification in the types of industries, policy formulation is not targeted to specific sectors. Policy is formulated for the SME sector as a whole which means we treat an organisation with less than 15 employees and one with 300 with the same rules. Cottage industries are a large part and treating them with the same policies as SMEs would not facilitate their growth. This automatically puts CMSMEs, which constitute 88% (2013) of the total SMEs [14], in a disadvantageous situation. According to DCCI president Rizwan Rahman, due to a lack of financial and policy support, CMSMEs cannot fully utilise their capacity and potential.[15]



ONE SIZE DOESN'T FIT ALL

If banks need to follow the same procedure to lend to the cottage and medium enterprises, it is in their economic interest to disburse funds to bigger fishes instead of small ones. Thus, many CMSMEs will be deprived of funding because of the unfair clustering in our policy formulation.

Absence of database and exhausting paperwork

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The next barrier to CMSME financing is the absence of databases for these enterprises. In fact, the latest data about the number of SMEs in Bangladesh comes from a 2013 census. Therefore, any policy step structured for SMEs is done without knowing their actual number. The absence of a database is an obvious bottleneck in SME loan disbursement. It also stands in the way of digitising the credit application process and carries the dreadful legacy of exhausting paperwork.

While paperwork is a bottleneck in all credit disbursements, the case is especially severe for CMSMEs, given that many entrepreneurs do not have the necessary documents. Their low financial inclusion means many transactions are hard to trace.

The cottage, micro, small and medium entrepreneurs even had difficulties getting government stimulus packages because of the complex disbursement process, collateral issues and absence database. The CMSMEs also lacked bank accounts, and there were no proper relationships between banks and entrepreneurs, which created a bottleneck in getting funds.[16]

The loan application process also requires the attachment of a business plan, but cottage entrepreneurs are often unlikely to have a well-defined one. Inconsistency and irregularity of document submission also slow down the process of fund acquisition. A big portion of this paperwork could have been avoided only if we had a national database of CMSMEs.

[13] Sukanta Halder, 'SME Foundation finally making SME database' The Daily Star (20 January 2022) <www.thedailystar.net/business/economy/news/sme-foundation-finally-making-sme-database-2943041> accessed 18 May 2022

[14] Ferdaus Ara Begum, (n 1)

[15] Staff correspondent, 'Collateral issues, no database holding back CMSME: experts' New Age (12 February 2022) <www.newagebd.net/article/162586/collateral-issues-no-database-holding-back-cmsme-experts> accessed 18 May 2022

[16] Staff correspondent, (n 15)



Problems in Credit Rating

In the face of high risks associated with CSME lending, credit rating is of enormous importance for this sector. Bangladesh currently has eight credit rating agencies, a number capable of creating substantial competition among the agencies. Market competition, coupled with the borrower pay model agencies in Bangladesh follow, can be in conflict with the possibility of fair rating. Since these agencies depend on payment from SMEs for revenue and need to survive market competition, their ability to provide fair ratings will naturally be limited. The borrower pay model poses a concerning question on the effectiveness of our credit rating agencies.

Plight Inflicted by the Pandemic

Access to finance has never been up to the mark for cottages and micro-enterprises, but the plight inflicted by the pandemic has made it worse. Small businesses lost 26 percent of their output by December 2020 because of the pandemic-induced lockdown, and micro and medium firms lost 20 percent due to restrictions between March and May.

Intermittent lockdowns have put many small entrepreneurs into a 'new debt trap' as their revenues fell, savings dried up, and continuous borrowing was the only way to keep businesses alive. This debt trap can potentially push many of the lower middle-class people into poverty again.

Under these grim circumstances, a Credit Guarantee Scheme of Tk 20,000 crore was approved in July 2020, followed by another of Tk 500 crore in January 2022 by the Bangladesh Bank to support CMSMEs in the aftermath of Covid lockdowns is certainly something worth being celebrated.[17]

[17] Star Business Report, 'BB rolls out 2nd credit guarantee scheme' The Daily Star (24 January 2022) <www.thedailystar.net/business/organisation-news/news/bb-rolls-out-2nd-credit-guarantee-scheme-2945891> accessed 18 May 2022

• **Flaws in the Stimulus Packages and Credit Guarantee Scheme (CGS)**

BDT 200 billion of the BDT 1.28 trillion stimulus package was allocated to CMSMEs to aid in their recovery. The funds were disbursed through commercial banks at a 9 percent rate, 4 percent of which would be paid by entrepreneurs and the rest by the government. Although stimulus packages were given, only 18.4 percent of micro and small enterprises received the packages, medium firms received 42.3 percent and large firms received 57.3 percent. Even though there were allocated funds for CMSMEs led by women entrepreneurs, 58 percent did not hear of it, and 93 percent did not apply.[18]

Various factors made the firms not use the stimulus packages. According to a study done by South Asian Network on Economic Modeling (SANEM), 89% of respondents said that it was a loan with soft terms and not a grant, 75% of 212 firms mentioned a lack of stimulus packages for the industry, 79% of 158 firms mentioned delays in receiving packages and 61% of 168 firms mentioned difficulties in bank formalities.[19]

Credit guarantee scheme entails that a portion of the loans given out to CMSMEs will be absorbed by the government. However, some aspects of the Credit Guarantee Scheme (CGS) design might be holding it back from creating optimum impact. According to Bangladesh Bank, the scheme required fulfilment of several terms and conditions and at least 20 types of documents for the disbursement of loans. This made the process a tedious one. According to MD Karuzzaman Khan, head of SME and senior vice president of Lankabangla, in case of default, it would take at least three years to get money from the scheme following the lengthy legal process. Clients also need to pay 1 percent commission on bank loans, which is another problem.[20]

The scheme requires a FI to have at least 3 years of experience in SME lending. But it doesn't specify what portion of the FI's portfolio should have been dedicated to the sector. As a result, a FI having 5 years of experience with only .05% of their portfolio dedicated to SMEs will be eligible for the CGS, while a FI having 2 years of experience with 10% of their portfolio dedicated to the sector will be excluded.

The CGS also requires FIs to have maintained an NPL rate of 10% or less to be eligible. But the stipulation isn't applicable for state-owned banks. This will lead to inefficient usage of a portion of the CGS in the hands of some inefficient state-owned banks.

[18] Nasrin Akther Lubna, Md Abir Hossain and Md Ezazul Islam, (n 3)

[19] Selim Raihan, Mahtab Uddin, Md. Tuhin Ahmed

, Israt Hossain, 'COVID-19 and Business Confidence in Bangladesh

' (SANEM, 2021) <<https://sanemnet.org/5th-round-survey-report-on-covid-19-and-business-confidence-in-bangladesh/>> accessed 18 May 2022

[20] Akanda Muhammad Jahid, 'What goes wrong with the credit guarantee scheme?' The Daily Star (27 June 2021)

<www.thedailystar.net/supplements/world-sme-day-2021/news/what-goes-wrong-the-credit-guarantee-scheme-2118621> accessed 18 May 2022

A state-owned bank with not-so-good performance may end up crowding out guarantee funds that would have been better managed by a good-performing commercial bank. This might also increase the moral hazard problem among state-owned banks.

Another loophole of the CGS is the claim settlement process after the occurrence of default. Lending institutions are required to file cases under the Money Loan Court Act 2003, which can be economically discouraging for commercial, financial institutions. Requiring lenders to spend legal resources for claim settlement can ultimately deprive the CMSMEs most in need of finance. [21]

● **Problems in Implementation of Digital Financial Services (DFS)**

From 2011 to 2018, Bangladesh's financial inclusion grew by 56.3% because of government policies, initiatives from the private sector and help from multilateral development partners. The growth of Mobile Financial Services (MFS), Agent banking by banks and NBFIs and Micro enterprise lending by MFIs facilitated financial inclusion. Irrespective of these, only 28.4% of 8.1 million MSMEs are not being served by the formal financial system.



Traditional financial service providers (FSPs) are not being able to help the segment due to a lack of access and high operational cost in these segments. Although the government have set up union digital centres, DFS labs etc., a significant target portion lack proper knowledge about these. Some of the major challenges in implementing DFS in MSMEs include-

- High operational cost makes it unlikely for formal financial systems to provide customised savings, loans and insurance products catered specifically for this segment.
- Lack of proper credit information.
- The financial and digital literacy of the segment is below the global standard.
- There is slow digital adoption in rural areas and the services offered are not as large as its peers.

[21] See Nafiz Ahmed, 'Precedents to be used to avoid the misuse of the Artha Rin Adalat Ain' The Daily Star (29 October 2019) <www.thedailystar.net/law-our-rights/law-watch/news/precedents-be-used-avoid-the-misuse-the-arthar-in-adalat-ain-1820158> accessed 18 May 2022

[22] LightCastle Analytics Wing, (n 4)

• The Way Forward

First and foremost, we have to determine the needs of these CMSMEs if we want to treat them differently from SMEs. This requires a targeted approach to these enterprises. According to a report by Mckinsey, there are three types of emerging market countries and Bangladesh is a 'cool' market. The 'cool' market countries mean the financial penetration is increasing at less than 1 percent per annum. Countries falling under this one are either close to saturation or have not created an environment where MSMEs can thrive.[23]

So far we can see the latter is true. We treat CMSMEs the same way we treat SMEs so their growth has not been facilitated. We need to ensure financial inclusion first so that they get what they need to grow. For this we need a thorough database of the CMSMEs. This will solve the credit rating problems and increase the digital footprint. This will eventually ease the process of getting funds. This will also facilitate easier access to funds by ensuring proper information due to increased financial inclusion as lack of necessary documents was one of the reasons they could not get credit.

Increasing digital and financial literacy is crucial. Facilitating CMSME owners with the right tools and knowledge to grow is also important. Government can help access the CMSMEs and tap into their needs. Once we have proper knowledge of the CMSME scenario of our country, it can help creating separate policies and practices for the enterprises.

Cottage and micro industries are becoming invisible under 'SMEs.' While small and medium industries benefit from the schemes, cottage and micro enterprises remain deprived of formal access to credit. The CMSME sector of Bangladesh has been championed for bringing many out of poverty. Unless we respond to the unique needs of the sector now, many will slide back into poverty again.

[23] Mutsa Chironga, Jacob Dahl, Tony Goland, Gary Pinshaw, Marnus Sonnekus, 'Micro-, small and medium-sized enterprises in emerging markets: how banks can grasp a \$350 billion opportunity' (McKinsey & Company, 2012) <www.mckinsey.com/~/media/mckinsey/industries/financial%20services/our%20insights/tapping%20the%20next%20big%20thing%20in%20emerging%20market%20banking/micro_small_and_med_sized_enterprises_in_emerging_markets_full_report.ashx> accessed 18 May 2022

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