

SME FINANCING OF COMMERCIAL BANKS IN BANGLADESH: POLICY DIRECTIONS BASED ON SME LOAN BORROWERS' VIEW



Abu Obida Rahid^{(a) 1}

^(a)Lecturer, Faculty of Business Administration, CCN University of Science and Technology, Cumilla, Bangladesh; E-mail: mailtorahid.cou@gmail.com

ARTICLE INFO

Article History:

Received: 10th October 2022
Accepted: 15th November 2022
Online Publication: 1st January 2023

Keywords:

Small and Medium Enterprises,
Commercial Banks, SME Financing

JEL Classification Codes:

A19, B10, B25, C10, C53

ABSTRACT

The importance of bank financing for the growth and development of Small and Medium Enterprises is extensively documented in the literature. SME finance is essential not only to starting an SME business but also to enhance the growth of the business. Unfortunately, SME businessmen are facing difficulties in getting and repaying all kinds of financing in Bangladesh. Moreover, because of financing problems, SMEs cannot enter the manufacturing industry spite many potentialities. This research aims to identify key financing obstacles encountered by Bangladeshi SMEs and recommend policy guidelines to tackle those obstacles. Necessary data were collected through a structured questionnaire from 200 SME loan borrowers of 10 commercial banks by using a simple random sampling technique. Descriptive analysis was performed to analyze collected data. The findings indicate some constraints related to SME financing, such as higher interest rates, complex documentation, etc. SME borrowers face various obstacles before and after the sanction of SME loans. Although some initiatives related to SME financing have been adopted recently, most are not yet implemented. Moreover, SMEs' existing financing policies are inadequate, poorly designed, and inconsistent.

© 2023 by the authors. Licensee CRIBFB, USA. This article is an open access article distributed under the terms and conditions of the Creative Commons Attribution (CC BY) license (<http://creativecommons.org/licenses/by/4.0/>).

INTRODUCTION

Small and medium-sized enterprises (SMEs) are acting as engines of economic development in both developed and developing countries. Bangladesh is not an exception. According to (Chowdhury et al., 2013), "SMEs contribute 50% of Bangladesh's industrial GDP and employ 82% of the total industrial sector employment". SMEs create new employment opportunities, decrease income inequality and alleviate poverty. The success or failure of SMEs depends on both within and outside activities, government support, publicity, research and development, labor management etc.

For a developing country like Bangladesh, SME business is necessary to create self-supporting for the people. In our country, the government has declared SMEs a priority industry for developing and utilizing the workforce. Despite contributing a considerable portion to the economy, this industry has faced many challenges because of limited financing facilities like most developing and under-developed countries. "The enterprises in this sector are not small enough to get credit facilities from MFIs and at the same time not large enough to get loans from formal financial institutions." (Nehereen, 2010).

SME finance is essential not only to start an SME business but also to enhance the growth of the business. Generally, three types of finances are required for an SME businessman, namely-equity capital, working capital and debt. Unfortunately, SME businessmen are facing difficulties in getting and repaying all these three kinds of financing in Bangladesh. Moreover, because of financing problems, SMEs cannot enter the manufacturing industry despite many potentialities. Commercial banks are also reluctant to provide SMEs financing because of higher transition costs, limited collateral and high-risk factors.

Recently, the government has taken many initiatives and schemes through Bangladesh Bank to refinance commercial banks to provide loans to SMEs. Have these initiatives brought any solution to the credit problems faced by

¹Corresponding author: ORCID ID: 0000-0001-6978-004X

© 2023 by the authors. Hosting by CRIBFB. Peer review under responsibility of CRIBFB, USA.
<https://doi.org/10.46281/ijsmes.v6i1.1831>

SME borrowers? Has the loan scenario been changed from the past? To answer these questions, a recent study needs to be undertaken to know the status of SME borrowers. Therefore, this research aims to investigate the present status of SME financing by commercial banks to identify financing constraints and provide proper policy guidelines for the future growth of SMEs in Bangladesh.

The objective of the Study

The primary objective of this research is to explore the current status of SME financing of Bangladeshi Commercial banks. Moreover, some specific objectives of this research are:

- To assess the salient features of SME loan takers from different commercial banks
- To identify the key financing obstacles to SMEs' progress
- To provide directions regarding sustainable and market-oriented SME financing for the development of SMEs

LITERATURE REVIEW

Many previous studies have tried to identify problems for the borrower of SME financing. In developing economies, SMEs face challenges like an institutional and legal obstacles, accessing finance in banks etc. According to Levy (1991), most SMEs confront these problems of their heterogeneous characteristics. On the other hand, some studies (Hossain, 1998; EBRD, 2004) showed that most SME businesses are family businesses in developing countries. They need to keep proper bookkeeping, and most have working capital financing problems. According to these studies, the lack of enough credit facilities is one of the key constraints of SME development in a maximum of developing countries.

In the study of Hossain (1998), it has been found that SME owners face various problems while receiving capital as the banks are reluctant to grant credit to SMEs. In most cases, financial organizations take too much time to process loans from SME borrowers. Further, low-quality information, low-quality financial statements and lack of adequate guarantees often create barriers for SME borrowers to access finance. According to Haque and Mahmud (2003), excessive interest rates and demand for collateral are key reasons to make it difficult for SME borrowers to access finance from formal institutions.

According to RAM Consultancy Services (2005), collateral, burdensome loan dispensation and excessive paperwork are considered key constraints of SME financing in many countries of Asia. Besides Beck, Demirgüç-Kunt and Maksimovic (2005) showed that in developing countries, SME financing problems are higher charging fees, interest rates to SMEs and a smaller share of investment loans. Demirgüç-Kunt and Maksimovic (1998) found that lack of formal financial statements, quality information and enough collateral are major constraints of SME financing worldwide.

Many studies have addressed the issues of SME financing of commercial banks in Bangladesh. However, some important studies on this particular issue have been discussed below.

Nehereen (2010) explored the current status of SME financing and tried to identify the influence of SME financing on the financial performance of an organization by taking Dhaka Bank Limited as a case study. Employing Independent samples t-test, the study found no significant relationship between SME financing and financial performance.

Chowdhury et al. (2013) tried identifying SME financing-related constraints by collecting primary data through structured questionnaires. The researchers took a sample of 100 SME units. The authors suggested strategies and policies based on the identified SME financing-related constraints.

Hossain et al. (2016) assessed the SME banking performance of Bangladeshi commercial banks by applying the stochastic frontier model. The study took a sample of 45 banks. The study found that the average performance score was 0.716, which means banks can enhance 30% SME banking performance by utilizing unchanged inputs.

Ali and Islam (2018) tried to explore the condition of SME financing and SME development policies in Bangladesh by collecting and analyzing primary as well as secondary data. The findings indicated that the SME sector was developing well compared to other sectors. Though the loan disbursement to the SME industry was slowly rising, the portion of the industrial loan to this sector is slowly declining in recent years. The researchers proposed that the government take necessary action to ensure easy access to SME loans.

MATERIALS AND METHODS

Sources of Data

Primary and secondary sources of information were utilized for collecting necessary data.

Methods and Data Collection

For primary sources of information, a questionnaire survey to SME loan borrowers, Personal interviews with the respective bank officials were conducted. On the other hand, for secondary sources of information, the annual Report and operational manual of SME banking of selected commercial banks, journals and books about SME issues were gone through.

Sampling Design

Target Population and Sampling Unit

The target population of this research is the SME loan borrowers of commercial banks who mainly live in Dhaka City. The sampling unit of this study is the borrowers who took SME loans previously.

Sampling Technique and Sample Size

The sample was randomly selected among the borrowers visiting the SME unit offices of selected commercial banks for different purposes. The sample size has been restricted to 200. The distribution of the sample size is given below.

Table 1. The distribution of sample size

Name of the Bank	No. of Respondents	% Respondents
Trust	30	15
AB	20	10
Bank Asia	15	7.5
Dutch-Bangla	17	8.5
One	20	10
Dhaka	18	9
Standard	22	11
Public	10	5
IF	25	12.5
Islami Bank Bangladesh	23	11.5
Total	200	100

Data Analysis

After collecting 200 responses, SPSS statistical software (Version 20) was used to perform descriptive analysis (frequencies and percentages) and to present the outcome.

RESULTS AND DISCUSSIONS

Demographic Analysis

Age of SME Loan Borrowers

Table 2 shows that the age group with the maximum frequency is 30 to 40 years. This group contributes to 39% of the total respondents. The second largest age group is 40 to 50, contributing 32%. It clearly shows that most SME loans are provided to aged and experienced people. However, only some borrowers are above 50 years old.

Table 2. Age of SME loan borrowers

Age Group	Frequency (f)	Percentage (%)
Below 20 years	0	0
20-30 years	38	19
30-40 years	78	39
40-50 years	64	32
50 years or more	20	10
Total	200	100

Source: Primary Data

Educational Qualification of SME Loan Borrowers

Table 3 shows that the educational qualification of most of the borrowers (49%) surveyed is below SSC. 15% are educated up to SSC, and 18% are educated up to the HSC level. 13% have completed graduation. Only 5% of respondents have a post-graduation degree.

Table 3. Educational qualification of SME loan borrowers

Education	Frequency(f)	Percentage (%)
Below SSC	98	49
SSC	30	15
HSC	36	18
Bachelor	26	13
Masters	10	5
Total	200	100

Source: Primary Data

Monthly Income of SME Loan Borrowers

Table 4 shows that most of the respondents (31%) belong to the income level of BDT 20,000 to 30,000. 25% of customers surveyed earn more than BDT 40,000 monthly. The monthly income of only 7% is less than BDT 10,000.

Table 4. Monthly income of SME loan borrowers

Monthly Income (BDT)	Frequency (f)	Percentage (%)
Below 10,000	14	7
10,000-20,000	36	18
20,000-30,000	62	31
30,000-40,000	38	19
40,000 or More	50	25
Total	200	100

Source: Primary Data

Business Experience of SME Loan Borrowers

Business experience is one of the important criteria for a borrower's eligibility. Table 5 shows that most of the respondents (34%) have business experiences ranging from 5 to 10 years. 28% have experience of fewer than five years. 18% have business experience of 10 to 15 years. Only 8% have experience of more than 20 years.

Table 5. Business experience of SME loan borrowers

Experience	Frequency (f)	Percentage (%)
Below 5 years	56	28
5-10 years	68	34
10-15 years	36	18
15-20 years	24	12
20 years or more	16	8
Total	200	100

Source: Primary Data

Business Assets of SME Loan Borrowers

Table 6 shows that most respondents (46%) have a business asset of BDT 5.00 to 10.00 lac. 20% of respondents have business assets less than BDT 5.00 lac. Only 8 % of total borrowers surveyed have more than BDT 20.00 lac business assets.

Table 6. Business assets of SME loan borrowers

Business Assets (BDT in lac)	Frequency (f)	Percentage (%)
Below 5.00	40	20
5.00- 10.00	92	46
10.00-15.00	30	15
15.00-20.00	22	11
20.00 or more	16	8
Total	200	100

Source: Primary Data

Nature of Business of SME Loan Borrowers

Table 7 shows that most respondents (66%) are involved in the trading business. 18% of borrowers are involved in production, and 10% of entrepreneurs provide service. Only 6% of respondents have other types of business.

Table 7. Nature of business of SME loan borrowers

Nature of Business	Frequency (f)	Percentage (%)
Trading	132	66
Manufacturing	36	18
Service	20	10
Others	12	6
Total	200	100

Source: Primary Data

Current Scenario of SME Financing

Purpose of SME Loan Taken

Table 8 shows that among the respondents, 20% of borrowers took an SME loan to purchase fixed assets. The majority of the respondents (66%) took loans to gain working capital, and only 14% took loans for other purposes.

Table 8. Purpose of SME loan taken

Purpose of SME	Frequency	Percentage
Purchase fixed asset	40	20
Gain working capital	132	66
Others	28	14
Total	200	100

Source: Primary Data

Amount of SME Loan Taken

Table 9 shows that most respondents (46%) took SME loans ranging from BDT 2.00 to 5.00 lac. 38% took a loan from BDT 5.00 to 8.00 lac. 10% of total borrowers surveyed took loans from BDT 8.00 to 11.00 lac. Only 6% took SME loans ranging from BDT 11.00 to 30.00 lac.

Table 9. Amount of SME Loan Taken

Amount of Loan (BDT in lac)	Frequency (f)	Percentage (%)
2.00-5.00	92	46
5.00-8.00	76	38
8.00-11.00	20	10
11.00-30.00	12	6
Total	200	100

Source: Primary Data

Term of SME Loan Taken

Table 10 shows that among the respondents, 4% took an SME loan for less than seven months. 8% of customers surveyed took loans for a period ranging from 7 to 14 months. Most respondents (52%) took a loan for 21 to 28 months. 6% took an SME loan for a long period of 35 months or more.

Table 10. Term of SME loan taken

Term of SME Loan	Frequency (f)	Percentage (%)
Below 7 months	8	4
7-14 months	16	8
14-21 months	20	10
21-28 months	104	52
28-35 months	40	20
35 months or more	12	6
Total	200	100

Source: Primary Data

Interest Charges on SME Loan Taken

Table 11 shows that among the respondents, 5% took an SME loan for a 12% interest rate, 15% took an SME loan for 13%, and 20% took an SME loan for a 13.5% interest rate. Most respondents (50%) took loans for a 14% interest rate. The remaining respondents (10%) took an SME loan for a 14.5% interest rate.

Table 11. Interest Charges on SME Loan Taken

Interest Rate on SME Loan	Frequency (f)	Percentage (%)
12%	10	5
13%	30	15
13.5%	40	20
14%	100	50
14.5%	20	10
Total	200	100

Source: Primary Data

Waiting Time between SME Loan Application and Sanction

Table 12 shows that among the respondents, 40% have to wait less than three months to get a loan to start a business. Most respondents (50%) have to wait 3-4 months to get the loan to start the business. Only 2% must wait more than six months to get the loan to start the business.

Table 12. Waiting Time between SME loan Application and Sanction

Waiting Time	Frequency (f)	Percentage (%)
Less than 3 month	80	40
3-4 month	100	50
4-5 month	10	5
5-6 month	6	3
More than 6 month	4	2
Total	200	100

Source: Primary Data

Collateral Given for the SME Loan

Table 13 shows that 46% of customers gave blank cheques as collateral, whereas 12% of respondents gave legal documents of assets. 22% gave blank cheques, and a legal document for the collateral required. 20% gave other types of security as collateral.

Table 13. Collateral gave for the SME loan

Collateral	Frequency (f)	Percentage (%)
Blank cheque	92	46
Legal document of asset	24	12
Both	44	22
Others	40	20
Total	200	100

Source: Primary Data

Mode of SME Loan Repayment

Table 14 shows that most SME loan borrowers (88%) surveyed repaid their loan through equal monthly instalments, whereas only 12% of respondents repaid their loan through a single instalment.

Table 14. Mode of SME Loan Repayment

Mode of Repayment	Frequency (f)	Percentage (%)
Single instalment	24	12
Equal monthly instalment	176	88
Total	200	100

Source: Primary Data

Choice of SME Loan Repayment Method

Table 15 shows that among the respondents, 84% of borrowers prefer to repay their loan by cash, and only 16% think it is more convenient to repay the loan through a cheque.

Table 15. Choice of SME loan repayment method

Repayment Method	Frequency (f)	Percentage (%)
By cash	168	84
By cheque	32	16
Total	200	100

Source: Primary Data

Problems Faced by SME Loan Borrowers

Table 16 shows that most respondents (40%) treated higher interest rates as the main problem of SME financing. 20% of respondents faced a complex documentation process while applying for the loan. 10% faced other problems.

Table 16. New Problems faced by SME loan borrowers

Problem	Frequency (f)	Percentage (%)
Late disbursement	16	8
CRO's misconduct	24	12
Higher interest rate	80	40
Additional charges	20	10
Complex documentation	40	20
Others	20	10
Total	200	100

Source: Primary Data

CONCLUSIONS

In developed and underdeveloped economies, SME entrepreneurs need sufficient funding facilities to survive and grow in the competitive market. Commercial banks traditionally avoid lending to SME borrowers due to the lack of their strong relationship with banks, facing the complexity of loan procedures, lack of proper bookkeeping, inability to offer collaterals etc. This paper seeks to examine the factors that influence SME borrowers' bank financing in Bangladesh.

The empirical findings indicate that SME borrowers still face various obstacles before and after the sanction of SME loans. Although some initiatives related to SME financing have been adopted recently, most still need to be implemented. Moreover, the existing financing policies for SMEs need to be more adequate, better designed and consistent. In this situation, we must understand that only addressing policy-level changes will provide the expected result if an appropriate institutional culture is set up and related authorities strongly desire to execute the policies.

Policy Directions

Since commercial banks play a major role in providing money and raising capital for a business organization in a developing country, they have to come forward for the expansion and growth of the Bangladeshi SME industry. However, many

commercial banks' SME unit faces many challenges when it comes to financing SMEs. Based on the findings of this study, the following policy guidelines are suggested to overcome SME financing-related obstacles:

- Considering the requirements and aspects of SME loans, the risk involvement and the profit margin ratio, the authority of commercial banks should expand SME financing facilities in rural and semi-urban branches to make the bank more profitable.
- Commercial banks should decentralize loan sanction facilities to the branches to decrease the high cost and processing period, which is a major obstacle to SME financing in Bangladesh. Moreover, multiple channels should be utilized to gather information about SME borrowers before processing the loan.
- Small booths or SME Centers should be set up in rural and semi-urban regions to meet SME loan demand by these centres at low cost since minimum investment and operational. Administrative costs are required to operate these booths.
- Proper monitoring and maintenance the SME finance should be ensured by assigning specific officers who will closely observe SME entrepreneurs' funding demand and inform the benefit of SME loans from the Bank.
- Arrangements should be made for the training of both employees and SME entrepreneurs. Moreover, workshops and seminars should be arranged on SME financing opportunities so that potential entrepreneurs become aware of and attract SME loans through interaction with bank officials.
- Commercial banks should organize more promotional activities through advertisements on radio and television, printing posters and banners since SME business persons from various parts of Bangladesh, especially in rural areas, need to be aware of the advantages of taking SME loans from banks.
- Every commercial bank needs to establish a research and development division to identify the challenges related to SME financing and to design a more appropriate SME financing strategy.
- Commercial banks are following traditional security-based funding. The fund should be given to SMEs based on past years' financial statements (For example, cash flow statements)
- Since commercial banks need to be more successful in financing SMEs properly, the government must create alternative funding facilities and even new organizations to fund SMEs.
- To solve the problem of anomalies and harmonization in SME policy and other policies, the government should take the initiative to adjust export, import, industrial and monetary policy through integration.

Author Contributions: Conceptualization, A.O.R.; Methodology, A.O.R.; Software, A.O.R.; Validation, A.O.R.; Formal Analysis, A.O.R.; Investigation, A.O.R.; Resources, A.O.R.; Data Curation, A.O.R.; Writing – Original Draft Preparation, A.O.R.; Writing – Review & Editing, A.O.R.; Visualization, A.O.R.; Supervision, A.O.R.; Project Administration, A.O.R.; Funding Acquisition, A.O.R. Authors have read and agreed to the published version of the manuscript.

Institutional Review Board Statement: Ethical review and approval were waived for this study because the research does not deal with vulnerable groups or sensitive issues.

Funding: The author received no direct funding for this research.

Acknowledgements: The views and opinions expressed in this article are mine and do not necessarily reflect the views of their institution.

Informed Consent Statement: Informed consent was obtained from all subjects involved in the study.

Data Availability Statement: The data presented in this study are available on request from the corresponding author. The data are not publicly available due to restrictions.

Conflicts of Interest: The author declares no conflict of interest.

REFERENCES

- Ali, M. R., & Islam, M. A. (2018). Present Status of SMEs and SME Financing in Bangladesh: An Overview. *Journal of Science and Technology*, 8 (1 & 2), 55-71.
- Bangladesh Bank (2006). Access to Finance by Small and Medium Enterprises (SMEs). *Financial Sector Review*, 2(1).
- Beck, T., Demirgüç-Kunt, A. S. L. I., & Maksimovic, V. (2005). Financial and legal constraints to growth: does firm size matter? *The journal of finance*, 60(1), 137-177.
- Chowdhury, S. A., Azam, K. G., & Islam, S. (2013). Problems and prospects of SME financing in Bangladesh. *Asian Business Review*, 2(2), 51–58.
- Demirgüç-Kunt, A., & Maksimovic, V. (1998). Law, finance, and firm growth. *The journal of finance*, 53(6), 2107-2137.
- EBRD (2004). SME finance in the early transition countries. The EBRD US experience, European Bank of reconstruction and development.
- Haque, A. K. E., & Mahmud, S. (2003). Economic policy paper on access to finance for SMEs: Problems and Remedies. *The Dhaka Chamber of Commerce and Industry (DCCI) & The Center for International Private Enterprise (CIPE) (CIPE is an affiliate of the US Chamber of Commerce, Washington, DC, USA)*.
- Hossain, N. (1998). *Constraints to SME development in Bangladesh*. Institutional Reform and the Informal Sector, University of Maryland, College Park.
- Hossain, M. K., Hossain, M. A., & Baten, M. A. (2016). Performance Evaluation of SME Banking in Bangladesh using Stochastic Frontier Analysis. *Asia-Pacific Journal of Business*, 7(1), 31-42.
- Levy, B. (1991). *Obstacles to developing Small and Medium-sized Enterprises*. Working paper Series no-0588, The World Bank.
- Nehereen, K. (2016). SME Financing and Its Impact on Financial Performance: A Case Study on Dhaka Bank Ltd. *Management Development*, 27(3&4), 47–92.
- RAM Consultancy Services (2005). *SME access to financing: addressing the supply side of SME financing* (Vol. 1). Regional Economic Policy Support Facility, ASEAN-Australia Development Cooperation Program, ASEAN Secretariat.

APPENDICES

Appendix A: Definition of Small or Medium Enterprise (SME)

“Small or medium enterprise refers to the establishment/firm/business which is not a public limited company and complies with the following criteria (Bangladesh Bank, 2016):

Table A1. Definition of SME by Bangladesh Bank

Enterprise	Measurement	Business	Service	Manufacturing
Small Enterprise	Based on fixed asset (Tk.)	5 lakh -1 crore	5 lakh -1 crore	50 lakh -10 crore
	Based on workforce	6 - 10	10 - 49	25 - 99
Medium Enterprise	Based on fixed asset (Tk.)	1 crore-15 crore	1 crore-15 crore	10 crore-30 crore
	Based on workforce	11 - 50	50 - 100	100 - 250

Note: If on one criterion, a firm falls into the 'small' category, while it falls into the 'medium' category based on the other criterion, the firm will be deemed as in the 'medium' category and vice versa." (Ali and Islam, 2018, p. 71)

Source: Bangladesh Bank

Publisher’s Note: CRIBFB stays neutral about jurisdictional claims in published maps and institutional affiliations.



© 2023 by the author. Licensee CRIBFB, USA. This article is an open-access article distributed under the terms and conditions of the Creative Commons Attribution (CC BY) license (<http://creativecommons.org/licenses/by/4.0/>).

International Journal of Small and Medium Enterprises (P-ISSN 2576-7712 E-ISSN 2576-7720) by CRIBFB is licensed under a Creative Commons Attribution 4.0 International License.