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Sources and Uses of Funds of SMEs in Bangladesh - An Empirical Study on Chittagong Metropolitan Area

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Abstract

Simultaneously the sources and the uses of funds play an imperative role in maximizing the worth of an enterprise. This paper investigates the necessity of effective sourcing as well as usage of funds of SMEs. Primary as well as secondary data have been utilized in the present research work. The collected data have been analyzed using some financial and statistical tools. Sample SME enterprises face problems in obtaining funds in terms of asset based collateral and high cost structure of funds from banks and financial institutions; in using funds in terms of insignificant investment in fixed assets, lack of investment opportunities, shortage of investable funds and in general low opportunity for expansion of their business. However, their dependency on inefficient finance service usually from informal sources is more. Accurate credit assurance scheme should be developed for the lending institutions in order to cover both the credit risk and additional loan management cost. Accessible investable funds along with investment opportunities in fixed assets should be developed for SMEs in Bangladesh.

Key Words: SMEs, Sources of Funds, Uses of Funds, Operating Cash Flow, Investing Cash Flow, Working Capital

JEL classification: B26, F65, G21, G23, G32, L29, L53, O12, O17

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1.0 Introduction:

Business Innovation Facility Bangladesh (2012) recognized that the role of SMEs is momentous in the economic development of a country. SMEs grant output gains and employment opportunities that help in developing the distribution of wealth. Moreover, the SME sector provides a platform for micro-enterprises, large enterprises and recognized companies to bloom. Euromonitor International from national statistics, Bangladesh (2014) observed that in spite of a very challenging environment both national and international, the economy of Bangladesh growing at 6% ranked fourth among the top five flourishing economies. Furthermore, 25% of GDP and 40% of manufacturing output were contributed by SMEs. The manufacturing sector comprising of micro enterprises, SMEs bagged a growth rate of 9% and hence contributed maximum to the growth of Bangladesh economy. In 2013, it was approximated that SMEs accounted for 90% and 99% of the private enterprises at 7.2 and 7.9 million firms before and after inclusion of micro enterprises respectively. 70%–80% of the nonagricultural workforce is employed by the SME sector.

Chowdhury (2007) found that SMEs in Bangladesh are identified by small capital, inadequate asset, insufficient credit knowledge, constraints to institutional loan, meager record maintenance practice, scanty financial disclosure regarding tax matter, elevated risk exposure and borrowing costs. As per the Annual Report of BB 2014-15 the rising SME sector is doing a crucial job in the economic development of Bangladesh encouraging private ownership and entrepreneurial skills, generating employment, diversifying economic actions, thereby contributing significantly to overall economic growth. Ahmed & Chowdhury (2009) found that for industrial development of least developed countries like Bangladesh, SMEs are really efficient means. Uddin (2008) acknowledged that in the developing countries, the performance of SMEs basically depend on macroeconomic policies in addition to definite promotion rules.

Shilpa and Rakesh (2013) articulated that fund management is the management of sourcing and using of funds of a firm. The finance manager should determine the sources of capital that ensure efficient use of funds so that repayments can be met duly. It is not possible to obtain long as well as short term objectives of funding without efficient use of funds. Ineffective management of funds might result in liquidity lacks. A finance manager requires funds for business growth, market competition, to keep business equipped and to uphold customer base. Each business proprietor has a dream for his business, which is frequently influenced by managing and stressing on the use of funds. With a set amount of funds, financial purposes and expectations will determine how business funds will be spent.

Researcher has accomplished an extensive review of literature on overall fund management of SMEs in Bangladesh. It has been found that a good number of studies have been made over SMEs financing in Bangladesh, effective working capital management in

SMEs, constraints and projections of SMEs credit management, constraints of SME development, financial distress in SMEs, performance evaluation of SMEs. But these studies individually did not cover the sources and uses of short term in addition to long term funds of SMEs. The present study basically has been conducted to evaluate the procurement and utilization of short and long term funds of SMEs in Bangladesh.

2.0 Literature Review

2.1 Sources of Funds

Shilpa and Rakesh (2013) observed that shareholders, debt holders, loans from banks and other financial institutions, deposits etc. are the different sources of funds. Before raising the funds, the sources should be very carefully identified considering some factors for instance cost of lifting funds, attached terms and conditions, load of charges on assets etc. Gitman (2000) asserted that the sources also depend on the financing policy of a firm. Basically, there are two sources of funds- “long term and short term.” Sources of long term fund consist of debt and equity which provide a very small portion of the working capital requirement. Only the working capital in permanent nature is supported by long term loan. This part is the net working capital-“the surplus of the current assets over the current liabilities.” Conversely, sources of short term fund include trade credit, cash credit, overdrafts and other current liabilities which may be used to finance temporary working capital needs. Gitman (2000) undoubtedly agreed that easy access to finance is a key variable in choosing the sources of financing, but its effect on the risks and returns can not be overlooked.

Bakht and Basher (2015) observed that in the past, Government tried to equip SMEs entrance to finance through marked lending that was 5% of bank loan. Furthermore, in 1988, BASIC Bank was organized for financing SMEs. There was also some banks fund obtained from global organizations to flourish the sector. In addition, Bangladesh Bank (BB) issued orders to commercial banks concerning working capital loan sanction and disbursement, make use of regular documentation process and time duration limit. Alam and Ullah (2006) found that in the national budget 2003-04, BB structured a Tk. 10.0 billion refinancing scheme for loan to SMEs at a 5% rate of interest where there was no collateral requirements. After the completion of this course successfully, government increased the fund to Tk. 25.0 billion in the next national budget 2004-05. Apart from this, IDA (International Development Agency) equipped US$ 10 million to SME development in the FY 2004-05. Rikta (2007) found that BB refinanced Tk. 5,341 million to 13 banks and 19 FIs of which Tk. 2,742 million (51%) and Tk. 2,599 million (49%) were disbursed to the banks and the FIs respectively. Among the banks, BRAC, Eastern, and Dhaka bank jointly received more than 50% of the total. Among the FIs, MIDAS, Uttara Finance, and United Leasing in total received 45% of the refinance facility. Furthermore, ADB (Asian Development Bank) signed a contract with BB to equip extra US$ 30 million to SMEs. Based on this program, the funding abilities of different financial organizations have been improved and till April 2005, BB paid out Tk.1237.34 million for refinancing that consisted of Tk. 237.26 million from World Bank and Tk. 999.98 million from BB.

According to BB Annual Report 2014-15, BB has commenced diverse programs for Banks and NBFIs to provide comparatively cheaper funds to SME. Particular importance has been given to the women entrepreneurs in order to blend them with the conventional development process of the country. Consequently, BB has reserved 15.0% of total SME financing for women entrepreneurs at the highest rate of 10.0%. During FY 2015, BB also continued refinancing facilities to Banks and NBFIs providing a total amount of Tk. 48.2 billion against 47,988 enterprises to expand this sector.

Alam and Ullah (2006) asserted that to conquer the obstacles of financing, Local Enterprise Investment Centre (LEIC) has been initiated so that SMEs can have enough access to capital fund, innovation, new technological knowledge and business habits through instituting joint venture with overseas or local business. Canadian International Development Agency (CIDA) and Industrial Development Leasing Company (IDLC) BD Limited mutually arranged the LEIC for developing a spontaneous non government sector that will work as a platform for economic growth and development. The International Finance Corporation (IFC) has signed a contract with United Leasing Company Limited (ULC) in Bangladesh to provide a local credit assurance of maximum $5 million. This credit assurance will aid ULC to take loan of the equal amount of long term local fund from Citi bank Bangladesh and employ that fund with a view to expanding its diversified portfolio of leases to the SMEs in Bangladesh. This will further assist the leasing companies to mobilize long-term local fund from the overseas banks to help the SME sector. Rikta (2007) found that in recent times MIDAS, to match with the government's new industrial policy has enhanced its credit ceiling from Tk. 30 million to Tk. 100 million for SMEs. Despite all these financing provisions for SMEs, the real scenario of institutional loan to this sector is such that it is insufficient due to collateral based lending. MIDAS (2004) observed that most of the financing sources of SMEs are friends and family (Informal sector 41%, Family 20% without interest and 4% with interest, NGO 17%, Bank 18%).

Table:1 SME loan to loan portfolio ratio **(Tk in crore)**

Nature of Banks	Tot al Loans	SME Loans	% of SME Loans	%% within SME Segment
State owned Banks	84,040	15,445	18%	13%
Specialized Banks	31,214	9,269	30%	8%
Foreign Banks	23,853	2,265	10%	2%
Private Commercial Banks	3,15,329	85,333	27%	74%
Non -Bank Financial Institutions	31,449	3,572	11%	3%
Total	**4,85,885**	**1,15,884**	**23.85%**	**100%**

Source: Asian Business Review, Vol. (2), issue 4, 2013

Table:2 SME loan achievement to target ratio **(Tk in crore)**

Nature of Banks	Loan Target	Loan Achievement	% of Achievement
State owned Banks	5,820	5,148	88%
Specialized Banks	5,565	3,690	66%
Foreign Banks	13,56	1,187	88%
Private Commercial Banks	58,974	73,412	124%
Non -Bank Financial Institutions	2,472	1,886	76%
Total	**74,187**	**85,323**	**115%**

Source: Asian Business Review, Vol. (2), issue 4, 2013

Table:3 Classified Loan to SME loans ratio **(Tk in crore)**

Nature of Banks	SME Loans	SME CL	% of CL to SME Loans
State owned Banks	15,445	2,657	17%
Specialized Banks	9,269	1,281	14%
Foreign Banks	2,265	227	10%
Private Commercial	85,333	4,567	5%
Non -Bank FI	3,572	421	12%
Total	**115,884**	**9,153**	**8%**

Source: Asian Business Review, Vol. (2), issue 4, 2013

2.2 Uses of Funds

Shilpa and Rakesh (2013) explained that fund management cannot work out without designing proper fund utilization strategy. It helps to ensure optimum utilization of funds considering the cost and risk factors involved. If there is spoiled of funds, it will simply result in ultimate loss for the business firm. The existing funds of business should be appraised frequently and employed profitably. With the growth of business worldwide, the task of financial manager is becoming more important for ensuring effective utilization of funds which will thereby minimize cost and maximize return of funds. This leads a firm to not only having a sound liquidity for both long and short term but also ensuring the maximization of shareholders' wealth. The use of short term funds can be recognized by investing those funds in working capital. The firm should maintain sufficient working capital and avoid investing much funds in cash, inventories, book debts etc. The use of long term funds may be acknowledged by employing those funds in long term asset. For long term capital investment decision, a vigilant evaluation of different choices must be made based on capital budgeting decisions; opportunity cost analysis; principles of safety, liquidity and profitability etc.

According to Brealey and Myers (2004), investment in working capital is the lifeblood of a company. There is no existence of business without working capital. Therefore, the first, and by far the most important application of working capital are in short-term assets investment. A firm requires minimum cash balance to meet up daily expenses and unforeseen costs. It also needs cash balances for speculation and compensation. The second objective of working capital is handling the seasonal or cyclical financial wants. Good numbers of businesses need to finance their costs in sales, purchase, production and collection prior to receiving payment from customers. Bhattachrya (2001) stated that if a working capital deficit exists in a firm, an aggressive working capital policy i.e short term funds are used to finance part of the non-current assets should be adopted.

3.0 Research Objectives:

The principal object of this research study is to appraise the sources and uses of funds of SMEs in Bangladesh. In order to achieve the principal object, the research study sets the subsequent definite objectives:

1. To examine the sources of funds of sample SMEs
2. To analyze the uses of funds of sample SMEs
3. To evaluate the cash flow performance of SMEs on financial ratios

4.0 Methodology of the study:

At the very outset of the research study a rigorous review of literature has been conducted. The literatures incorporated books, publications and journals connected to sources and uses of funds of SMEs. The entire numbers of sample for the research study was 40 SME enterprises that were collected from 11operating SME sectors and 30 commercial banks in diverse locations of Chittagong Metropolitan area based on convenience sampling method. Data were collected from June; 2017 to August; 2017 in order to figure out the sources and uses of funds for 5 years from 2011-2015. A self-made questionnaire was prepared to gather primary data keeping the objective of the research study. Questionnaire consists of mainly close-ended and a little bit open ended questions. The questionnaire was disseminated among the relevant executives of SMEs and Banks in Chittagong metropolitan area. The interviewees were individually asked and the questionnaires were filled up by the interviewer depend on the response of the interviewees. After collecting data, Common Size Fund Statement, Descriptive Measures such as Mean, Range, Standard Deviation and Coefficient of Variation, and relevant financial ratios were applied to examine the gathered data.

5.0 Findings and Analysis:

5.1 Analysis of Sources of Long Term Capital of sample SMEs

Table 4: Sources of Long Term Capital

Sources of L.T.Capital	No. of Respondents										
Title	**2011**	**% of Resp.**	**2012**	**% of Resp.**	**2013**	**% of Resp.**	**2014**	**% of Resp.**	**2015**	**% of Resp.**	**Avg. % of Resp.**
Share Capital	40	**100**	40	**100**	40	**100**	40	**100**	40	**100**	**100**
Retained Earnings	40	**100**	40	**100**	39	**98**	38	**95**	38	**95**	**98**
Long Term Debt Capital	14	**35**	16	**40**	16	**40**	18	**45**	21	**53**	**43**

Source: Data have been compiled by Researcher

It has been found from the analysis of Table 04 that almost all the sample SMEs explores all the relevant sources-equity capital, retained earnings and long term debt (loans from banks and other informal sectors). From the perusal of this table, it has been noticed that most of the sample SMEs have not been able to avail of long term debt capital at the initial of the study period; although no. of sample SMEs using long term debt capital have increased at the tail of the study periods. This indicates that SMEs are in the funding trap with respect to long term debt capital especially from commercial banks. The researcher has observed during conducting interview of sample respondents that they are facing problems in availing long term loans from commercial banks due to collateral, unfavorable policy of commercial banks towards SMEs, non-diversified activities of commercial banks etc.

5.2 Analysis of Sources of Working Capital of sample SMEs

Table 5: Sources of Working Capital

Title	No. of Respondents										
Sources of Working Capital	**2011**	**% of Resp.**	**2012**	**% of Resp.**	**2013**	**% of Resp.**	**2014**	**% of Resp.**	**2015**	**% of Resp.**	**Avg. % of Resp.**
Trade Credit	40	**100**	40	**100**	40	**100**	40	**100**	40	**100**	**100**
Accrued Liabilities	30	**75**	32	**80**	32	**80**	35	**88**	35	**88**	**98**
S.T. Debt	40	**100**	40	**100**	40	**100**	40	**100**	40	**100**	**100**
Long term sources	20	**50**	25	**63**	30	**75**	30	**75**	32	**80**	**69**

Source: Data have been compiled by Researcher

It can be drown from the analysis that sample SMEs can be segmented into two: most of the sample SMEs (69%) follows moderate working capital financing policy and the rest has followed aggressive working capital financing policy. This signifies that sample SMEs are found to match between assets and liabilities with respect to terms to maturity. This has led researcher to draw an inference that sample SMEs are making risk-return trade off.

5.3 Examination of Cash Flow Performance on Financial Ratios

Cash flows from operating activities refer to whether a firm can create adequate cash flows to continue its operations without financing new capital. Though there is no standard measure for operating cash flow to sales ration but a rising tendency in this ration is a positive sign of excellent operations management. Investing cash flows is a significant facet of a firm's growth and development. If the cash flows are negative signify that the firm is investing more in fixed assets, whereas if it is positive indicate that the firm has sold off its fixed assets to create immediate cash. For a rising firm it is common to have negative investing cash flows. But it requires keeping track of these two related issues- investing cash flows and profitability. At times it may be needed to restrict the investment growth to ensure solvency.

5.3.1 Analysis of Operating Cash Flow (OCF) Structures of Sample SMEs

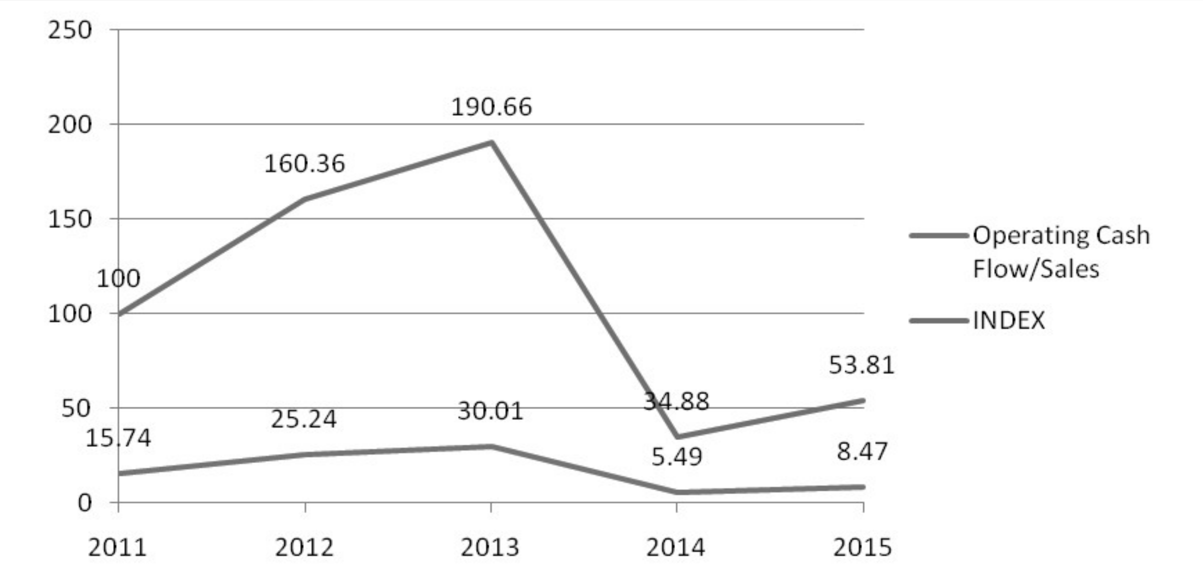
Table 6: OCF Structures

Ratios	OCF /Sales (%)	Index
2011	15.74	100
2012	25.24	160.36
2013	30.01	190.66
2014	05.49	34.88
2015	08.47	53.81
Mean	**17.00**	
Range	**24.52**	
Max. Level	**30.01**	
Min. Level	**05.49**	
S.D	**10.54**	
C.V	**62**	

Source: Annual Reports of sample SMEs

The study has found from the analysis that rate of OCF to Sales across study periods are moving ups and down and the average OCF to Sales is 17%. The sample SMEs have maintained higher OCF to Sales in the years 2012 and 2013; and lower OCF to Sales in the remaining years of study periods. This situation is substantiated by standard deviation of 10.54%, and range of 24.52%. This indicates that sample SMEs have been maintaining poor ratio of OCF to Sales, signifies poor performance in generating operating cash flow from operating activities during operating periods. The trend in OCF to Sales across study periods has been exhibited in Figure 1 as follows:

Figure 1: The trend in OCF to Sales



Notes: OCF to Sales of 2011=100 (Base)

From the examination of Figure 01, it has been observed that OCF to sales has been increasing at a decreasing rate across the study periods. This indicates that operating cash managements of sample SMEs during study periods have been found poorly working, leading to the poor recovery of cash. This signifies the highest cost of working capital funds and more dependence on the funds for financing working capital from outside sources. This scenario has been truly reflected by the use of outside funds across study periods.

5.3.2 Analysis of Investing Cash Flow (ICF) Structures of Sample SMEs

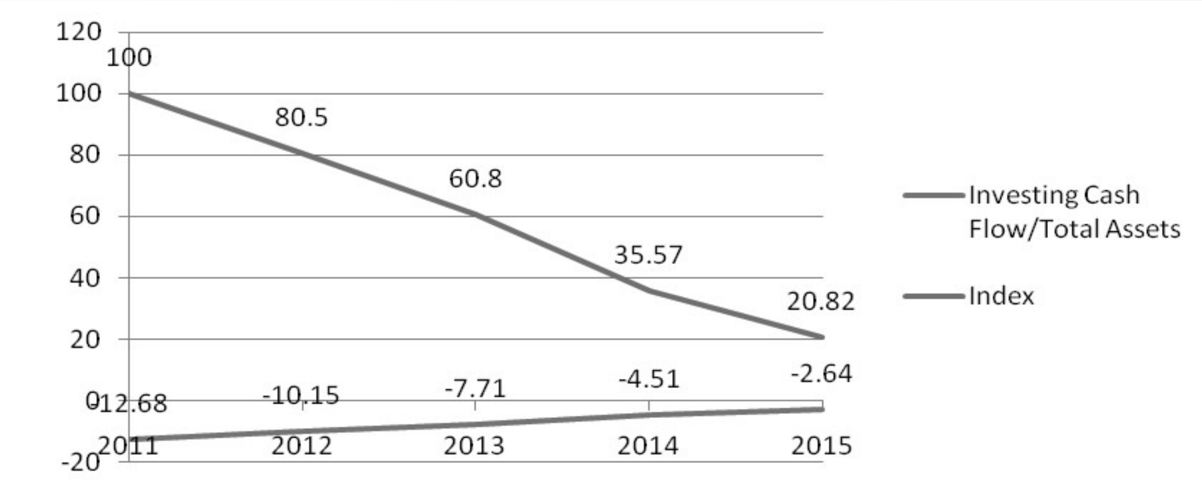
Table 7: ICF Structures

Ratios	**ICF/Total Assets (%)**	**Index**
2011	-12.68	100
2012	-10.15	80.05
2013	-07.71	60.80
2014	-04.51	35.57
2015	-02.64	20.82
Mean	**-7.54**	
Range	**10.04**	
Max. Level	**-02.64**	
Min. Level	**-12.68**	
S.D.	**4.08**	
C.V	**-54.11**	

Source: Annual Reports of sample SMEs

The study has found from the analysis that rate of ICF to TA across study periods are moving ups and down and the average ICF to TA is -7.54%. The sample SMEs have maintained higher ICF to TA in the years 2011 and 2012; and lower ICF to TA in the remaining years of study periods. This situation is substantiated by standard deviation of 4.08%, and range of 10.04%. This indicates that sample SMEs have been found to have invested in fixed assets to an insignificant amount of funds. However the performance of investment in assets across the study periods has been captured through a trend line exhibited in Figure 2 as follows:

Figure 2: The trend in ICF to TA



Notes: ICF to TA of 2011=100 (Base)

From the examination of Figure 02, it has been observed that investing cash flow to total asset has been increasing at a decreasing rate across the study periods. This indicates that investment of funds of sample SMEs has been decreasing over the study periods. This poor situation can be attributed to the factors such as paucity of investable funds, lack of investment opportunities, low opportunity for expansion etc. Although, SMEs have ample opportunities for growth in Bangladesh as compare to other developing countries.

5.3.3 Analysis of Financing Cash Flow (FCF) Structures of Sample SMEs

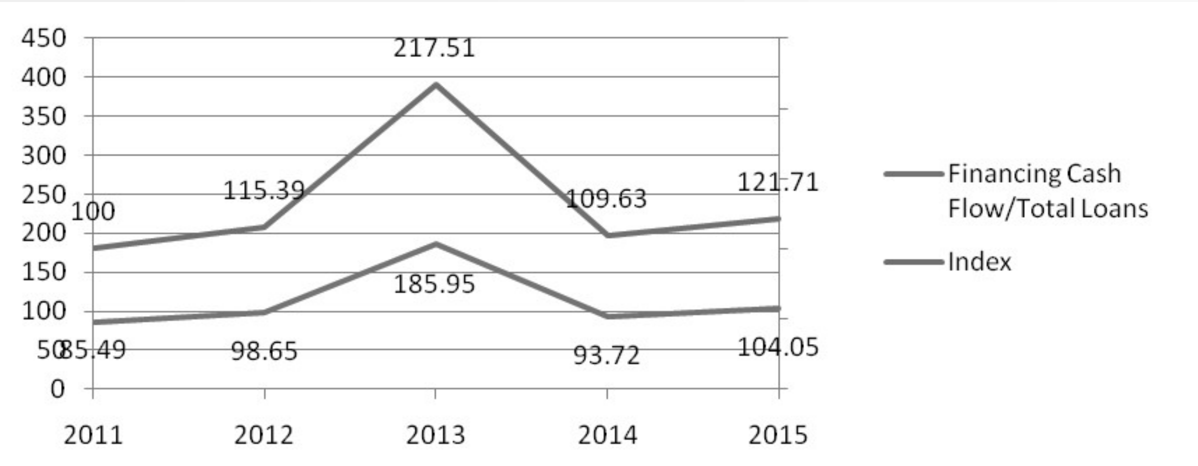
Table 8: FCF Structures

Ratios	FCF /Total Loans (%)	Index
2011	85.49	100
2012	98.65	115.39
2013	185.95	217.51
2014	93.72	109.63
2015	104.05	121.71
Mean	**113.58**	
Range	**100.46**	
Max. Level	**185.95**	
Min. Level	**85.49**	
S.D.	**41.03**	
C.V	**36.12**	

Source: Annual Reports of sample SMEs

The study has found from the analysis that rate of FCF to TL across study periods are moving ups and down and the average FCF to TL is 113.58%. The sample SMEs have maintained higher FCF to TL in the year 2013; and lower FCF to TL in the remaining years of study periods. This situation is substantiated by standard deviation of 41.03%, and range of 100.46%. This indicates that sample SMEs have been maintaining poor ratio of FCF to TL, signifies poor performance in generating financing cash flow from financing activities during financing periods. The trend in FCF to TL across study periods has been exhibited in Figure 3 as follows:

Figure 3: The trend in FCF to Total Loans



Notes: FCF to Total Loans of 2011=100 (Base)

Failure to From the examination of Figure 03, it has been observed that financing cash flow to total loans has been increasing at a decreasing rate across the study periods. This indicates that sample SMEs have been found to use funds from outside across study periods. Although, the use of funds from outside is moving ups and downs, this situation is similar to the utilization of funds in fixed assets.

6.0 Major problems relating to sourcing and using funds of SMEs:

i. Unfavorable policy requirements of commercial banks towards SMEs.
ii. abide by collateral requirements of the banks to get long term loan.
iii. No diversified investment activities of commercial banks with SMEs.
iv. A percentage of SMEs (31%) follow aggressive working capital financing policy.
v. Highest cost of working capital financing.
vi. More dependency on inefficient finance service usually from informal sources.
vii. Funds from informal sources are moving ups and downs.
viii. Operating cash management is poorly working leading to poor recovery of cash.
ix. Paucity of investable funds of SMEs in fixed assets.
x. Lack of investment opportunities.
xi. Low opportunity for expansion of SMEs business.

Ahmed (2006) observed that in Bangladesh, easy access to institutional finance is one of the main barriers to the growth of SMEs. Banks are unwilling to grant loans to SMEs as SME loan is not a lucrative and cost-effective initiative. Due to small capital base, inadequate assets and incapability to obey additional security based lending SMEs are treated as more risky borrowers. Administrative costs in terms of close monitoring and supervision of SME operations are also high. Akterujjaman (2010) also identified that banks are not eager to grant small size of loan for high monitoring cost. Bakht and Basher (2015) asserted that limited capital and no accesses to institutional loan compel SMEs to depend on informal sources, which ultimately demonstrate indefensible growth. They also asserted that however, additional securities that SMEs can arrange get exhausted in affording the loan capital lagging behind SMEs to look for working capital loans from banks. Different alternatives to collateral supported loan have been recommended for the growth of SMEs such as appropriate credit guarantee schemes, use of assets like fixture, equipment, vehicles etc. as collateral. Besides, sales revenues, trade credit, inventories etc. are considered the sources of working capital.

7.0 Policy Implications

On the basis of important findings, following policies and strategies have been recommended for making fund management of SME enterprises most effective in order to accomplish the optimal object.

i. Favorable financing policies should be made by the commercial banks in addition to rationalizing the existing policies to flourish the SME sectors as a buffer of the economic system

ii. If lending agencies spread out their liberal funding policies, dependency on inefficient finance service usually from informal sources would be minimized

iii. Banks should establish deposit relationship rather than asset ownership with SMEs and using cash flow as the basis of credit worthiness

iv. Banks could potentially minimize the default risk if they evaluate SMEs on the basis of information received from their business service providers and receivers

v. Implementation of close screening and monitoring in the post-disbursement phase will result in reduced risk of lending without collateral

vi. Suitable credit guarantee schemes will have to be implemented in order to cover the risk and the added cost of loan organization

vii. Given heavy reliance of the national economy of Bangladesh on the SMEs, commercial banks should diversify their investment activities more with SMEs sectors

viii. Almost all SME enterprises are said to be adopted a moderate working capital policy in order to minimize cost of funding

ix. SME enterprises can avail funds from spontaneous credit sources at lowest possible opportunity cost

x. SME enterprises should maintain better liquidity and operating performance for easy obtaining of funds from banks and financial institutions

xi. Accessible investable funds along with investment opportunities in fixed assets should be developed for SMEs in Bangladesh

8.0 Conclusion:

Finance is crucial to each type of business and it is in fact termed as the lifeblood of a business firm. Hence, its organization needs extraordinary concentration. Fund management is the action of management that involves financial planning, obtaining, investing and controlling of funds. Business firm's future will depend upon not only the financing but also on the efficient employment of funds for the development and growth of business. If funds are financed and utilized efficiently, then the firm will have a healthy growth in all dimensions.

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