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## A Note on the Contribution of Small and Medium Enterprises to GDP in Bangladesh

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## 1. Background

In Bangladesh, one of the key strategic thrusts of anti-poverty policy is to accelerate and expand the scope of pro-poor growth that would increase income and employment of the poor. For promoting such growth, several elements are emphasized, such as rapid growth of agriculture and the rural non-farm sector, expansion of small and medium enterprises (SMEs), development of rural infrastructure, and similar other activities that support labor-intensive growth of the economy.<sup>1</sup> In this context, the potential benefit of developing SMEs is widely emphasized for creating employment, furthering economic growth, and ensuring the foundation of a robust and competitive industrial sector in the country. Such enterprises are also seen as vital to rural industrialization and the driving force for ensuring a more equitable distribution of income, in promoting more efficient utilization of local resources, in encouraging entrepreneurial development, and in supporting export growth and diversifying the export base.

In view of such enormous opportunities, the government has given special attention to the development of SMEs in Bangladesh.<sup>2</sup> Despite the importance, the contribution of SMEs to the country's GDP and employment has remained somewhat unclear especially in view of the multiplicity of the definition of SMEs adopted by different institutions/agencies and the lack of information as per the required format. This note provides a review of the present status of SMEs, especially in terms of contribution to GDP and employment, and identifies the underlying policy implications for ensuring rapid growth and development of the SME sector in Bangladesh.

## 2. Industrial Restructuring: The Way Forward

Over the years, the economy of Bangladesh has undergone significant structural transformation in terms of sectoral contribution to GDP. The share of agriculture in GDP declined from nearly 32 percent in FY81 to 22 percent in FY07. The share of industry, on the other hand, increased from 21 percent to 29 percent while the contribution of the services sector increased slowly from 47 percent to 49 percent over the same period. Within the industry sector, the contribution of manufacturing sector to GDP increased from 11.2 percent to 17.8 percent between 1981 and 2007 showing an average growth rate of 6.5 percent per year. Within manufacturing, the share of small scale industry in GDP increased from 3.2 percent in 1981 to 5.1 percent in 2007; while the corresponding share of large and medium

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<sup>1</sup> See, GOB 2005.

<sup>2</sup> In addition to fiscal and financial measures, several recent initiatives to streamline the institutional arrangement may be mentioned, such as the constitution of a national task force on SME development, creation of a SME adviser panel, formation of a SME foundation, and other specific measures such as the refinance scheme taken up by the Bangladesh Bank.

scale industry increased from 8.0 percent to 12.7 percent.<sup>3</sup> While the average yearly growth rate of both small scale industry and large and medium scale industry over the 1981-2007 period was similar at 6.5 percent, small scale industry witnessed higher growth rates in recent years. During 2001-2007, the average growth rate of small scale industry was 8.1 percent compared with 6.8 percent in the 1990s and 5.2 percent in the 1980s.

In this context, within the ongoing restructuring process in the manufacturing sector, an important issue that requires urgent consideration is the uneven nature of the country's manufacturing structure. In many respects, Bangladesh's manufacturing structure is characterized by a *missing middle*. The employment in the manufacturing sector is concentrated at the two extremes: small (and cottage) industries and large industries. Similar concentration is also found in manufacturing production and assets. In particular, small informal enterprises dominate the country's rural industrial structure, having close links with agriculture through input and output markets. These also cater to the consumption needs of the rural population.

Within the largely dualistic structure, productivity gap between the two groups is wide. This is reflected in lower wage rates that prevail in the small enterprises compared with those in large industries. Moreover, with the majority of the industrial labor working in the 'low-wage low-productivity' smaller enterprises, the distribution of wage is also inequitable.

Thus a key challenge to developing Bangladesh's manufacturing sector with capability to expand the rural economy and reduce rural poverty is to reduce the productivity gap between small (and mostly informal) and large enterprises and facilitate the transformation of the small enterprises into medium sized ones having higher productivity. Essentially the challenge is to facilitate the upward mobility of the small firms along with preserving their employment generating potential to absorb the growing labor force.

In the present context of globalization, the desired industrial restructuring needs to be seen from a dynamic perspective as well. The SMEs should be so structured that these enterprises can play the role of 'agents of change' and 'sources of innovation'. The strategic thrust of the SME sector should be to create dynamic complementarities with large enterprises in areas where SMEs have advantages, such as 'customization' (low volume niche market) and 'innovation' (low volume temporary monopolies). The SMEs should help develop/adopt new technologies, nurture skills, and develop new products. This is needed to sustain a process of continuous regeneration of industrial activities and flexible specialization. In the process, the SMEs will also help to deepen the country's industrial structure.

### **3. SMEs: Definition, Structure and Growth**

There does not exist any unanimous and universally acceptable definition of SMEs in Bangladesh. The practice of different institutions/agencies is to define SMEs keeping their own perspectives and strategies in view. Conceptually, the main difference among the

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<sup>3</sup> In the published statistics, the information on medium-scale industry is lumped with large scale industry so that separate contribution of SMEs as a group cannot be derived.

alternative definitions arises in terms of number of employment and volume of invested capital (Box 1). The Policy Strategies for Development of SMEs (2005) defines small and medium enterprises within the manufacturing sector on the basis of volume of capital.<sup>4</sup> For non-manufacturing enterprises (e.g. services and trading), small and medium enterprises are defined only in terms of active employment.<sup>5</sup> The Bangladesh Bureau of Statistics (BBS) defines SMEs using employment status only. The Bangladesh Bank (BB), on the other hand, defines SMEs considering both the volume of investment and the number of workers. For policy purposes, it is important therefore to adopt a uniform definition of SMEs to facilitate regular monitoring of growth and structural change in the sector and evaluate the impact of policies based on comprehensive information covering the entire SME sector. Recently, acting on the recommendation of the Better Business Forum (BBF), BB has revised the definition of SMEs in consultation with the Ministry of Industries and others.<sup>6</sup> This is expected to provide a uniform definition of SMEs for use by all stakeholders and help the banks and NBFIs in identifying genuine SMEs and disbursing loans. In this note, we have used the BBS definition for analyzing SME development, considering the availability of data in formats consistent with the BBS definition.

### **Growth and structure of SMEs**

Available information suggests relatively rapid growth of SMEs in Bangladesh, especially since the 1990s. The data on the number of establishments show that small enterprises grew by 4.6 percent per year over the period FY78 to FY03, while medium enterprises grew by 6.4 percent during FY 82-FY 03 (Table 1). With special emphasis given to the development of SMEs, it is likely that these growth rates have continued and probably increased in recent years.<sup>7</sup> The number of small enterprises increased to 55,916 in 2001 from 24,590 in 1981. As per the Economic Census 2001 and 2003 (BBS), the number of small enterprises stood at 74,629 which is 87 percent of the total number of enterprises, while the number of medium enterprises is 5,125 (6 percent). For large enterprises, the number is 5,673 which is 7 percent of the total number of enterprises (Table 2).

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<sup>4</sup> Manufacturing enterprises having capital of Tk. 15 million excluding land and building are called small enterprises, while those having capital up to Tk. 100 million are termed medium enterprises.

<sup>5</sup> Enterprises having less than 25 full time workers are considered small enterprises while those having full time workers between 25 and 100 are called medium enterprises.

<sup>6</sup> See ACSPD Circular No 08, Bangladesh Bank.

<sup>7</sup> Uddin (2006) reports that the number of SMEs has increased by 5.2 percent during FY03-FY06, while Ahmed (2003) suggests that small enterprises, on average, grew by 6.4 percent during 1981-2001.

Year	Small enterprises	Medium enterprises
FY 78	24,005	...
FY 82	...	1,302
FY 03	74,629	5,125
<b>Growth rate (%)</b>	<b>4.64</b>	<b>6.43</b>

Source: Ahmed 2001, BBS, and authors' calculation.

The enterprises are concentrated in six broad categories: manufacturing including agro-based manufacturing; education; wholesale and retail trade; hotel and restaurant; finance, insurance and business services; and community, social and personal services. The distribution of SMEs over different categories shows that the share of small manufacturing enterprises in total small enterprises is nearly 35 percent while similar share of medium manufacturing enterprises is 45 percent (Table 3). The share within different SME's is also changing over time (Table 4).

BSIC sector/category	In number		Share in total, %	
	Small	Medium	Small	Medium
1. Mining and quarrying	132	35	0.18	0.68
2. Manufacturing	25,985	2,311	34.82	45.09
3. Electricity, gas, water	228	63	0.31	1.23
4. Construction	422	62	0.57	1.21
5. Wholesale and retail trade	6,599	218	8.84	4.25
6. Hotels and restaurant	3,426	75	4.59	1.46
7. Transport, storage and communication	1,839	152	2.46	2.97
8. Bank, insurance, financial institution.	5,797	387	7.77	7.55
9. Real estate and renting	879	102	1.18	1.99
10. Public admin. and defense	5,339	587	7.15	11.45
11. Education	19,446	623	26.06	12.16
12. Health and social work	2,219	323	2.97	6.30
13. Community social & personal services	2,318	187	3.11	3.65
<b>Total</b>	<b>74,629</b>	<b>5,125</b>	<b>100</b>	<b>100</b>

Source: *Economic Census 2001 and 2003, BBS.*

#### 4. Contribution of SMEs to Employment and GDP

The contribution of SMEs to employment, GDP, and other important economic aggregates is significant although it is difficult to measure many of these contributions and their changes over time due to paucity of data.

##### Employment

One significant advantage of SMEs in a labor abundant economy like Bangladesh is the huge employment generation potential of such enterprises due to labor intensive nature of most of the SME activities. The available information shows that the number of total employed labor force has been increasing over time in Bangladesh (Table 5). Between 1986 and 2006, the labor force grew by nearly 3 percent while employment grew by 2.6 percent. Over the period,

most of the employment growth took place in the SME sector (Tables 6 and 7). In the small enterprises, employment grew by 4.8 percent during 1978-1991 and by 5.5 percent during 1991-2001. Employment growth in the medium enterprises is estimated at 9.6 percent during 1988-2003. SEDF (2003) reports that between 80 percent and 85 percent of the total industrial employment and 23 percent of the country's overall employment is accounted for by the SMEs. Mondol (2006) reports about 40 percent of the country's total labor force is engaged in SMEs.

**Table 4: Changes in sectoral distribution of SMEs, 1978-1993**

Industry/sectors	Small industry survey, 1978		Directory of Manufac. industries,1993		Small industry survey, 1993		SMEs listed with BSCIC	
	No.	%	No.	%	No.	%	No.	%
Food & allied	17,358	72	7,623	31	21,080	55	8,152	46
Textile & apparels	1,391	6	5,714	23	3,196	8	741	4
Forest & furniture	886	4	1,804	7	1,745	5	1,794	10
Paper, printing, etc	1,092	4	1,078	4	2,385	6	590	3
Chemical, rubber, etc	527	2	1,903	8	2,864	7	1,026	6
Glass, ceramics, etc	218	1	2,359	9	1,113	3	124	1
Basic metals, engineering	1,743	7	483	2	3,078	8	2,987	17
Fabricated metal/electrical	646	3	3,455	14	1,880	5	1,989	11
Others	144	1	526	2	953	3	245	2
<b>Total</b>	<b>24,005</b>	<b>100</b>	<b>24,945</b>	<b>100</b>	<b>38,294</b>	<b>100</b>	<b>17,648</b>	<b>100</b>

Source: Uddin 2002.

**Table 5: Growth of labor force and employment**

Year	Labor force (million)	Labor force growth %	Employment (million)	Employment growth %
1985/86	30.9	...	30.6	...
1999/2000	40.7	2.10	39.0	1.83
2002/03	46.3	4.59	44.3	4.53
2005/06	49.5	2.30	47.4	2.33
1986-2006	...	2.90	...	2.61

Source: Labor Force Survey (various years), BBS.

**Table 6: Employment in SMEs**

Year	Small (thousand)	Average growth (%)	Medium (thousand)	Average growth (%)
1978	322.1	...	...	...
1982	...	...	51.63	...
1991	523.0	4.80	...	...
2001	808.9	5.47	...	...
2003	...	...	156.05	9.63

Source: Uddin 2002 and Economic Census, 2003, BBS.

**Table 7: Distribution of employment of SMEs and large industries, 2001/2003**  
(% of total persons employed)

Sector	Small	Medium	Large
Food and tobacco	2.8	0.5	3.1
Textile manufacturing	6.0	1.3	13.2
Ready-to-wear apparels	0.7	0.3	20.1
Wood, leather & paper printing	1.1	0.2	1.4
Chemicals and plastics	0.7	0.2	1.7
Non-metallic mineral products	0.9	1.3	4
Fabricated goods, electrical and means of transport	1.6	0.5	1.7
Mining and manufacture nes	0.1	0.1	0.2
Various personal services	9.3	1.8	5.1
Education/ healthcare	12.6	2.2	5.2
<b>Total</b>	<b>35.9</b>	<b>8.5</b>	<b>55.6</b>

Source: Chowdhury, 2006.

### Output and value added

In general, the SMEs have more flexibility compared with large enterprises in terms of capital, labor, technological know how, and other dimensions of their operation. Uddin (2006) argues that SMEs are more efficient than the large scale enterprises. Some comparable data on gross output, value added, and profit of SMEs and large firms show that value added as percent of gross output is lower for SMEs than for large firms (Table 8). On the other hand, value added per worker and profit are higher for SMEs. Labor productivity (value added per worker) for SMEs is Tk. 96.7 thousand while it is Tk. 94.7 thousand for large firms.

**Table 8: Output, value added and profitability of SMEs and large firms, 2005**  
(million Taka)

Indicators	Small firms	Medium firms	SMEs	Large firms	All firms
Gross Output (GO)	23,801	34,034	26,892	183,541	135,067
Value added (VA)	3,642	5,337	4,185	36,080	26,112
VA as % of GO	15.3	15.7	15.5	19.6	19.3
VA per worker (Tk. 000s)	106.3	76.4	96.7	94.65	96.3
Gross Profit (GP)	2,430	2,497.5	2,452	16,058	11,806
GP per worker (Tk.000)	66.6	33.2	55.9	43.7	47.5
GP as % of GO	10.2	7.33	9.08	8.74	8.74

Source: Chudhury 2006.

The contribution of SMEs to the country's GDP varies with the contribution of SMEs to industrial output, the estimate of which differs widely across studies. The commonly quoted figures vary within 40 percent to 50 percent of the total manufacturing value added. According to ADB (2003), food and textile units including garments account for over 60 percent of the country's registered SMEs. It is also maintained that the SMEs have undergone significant structural changes in terms of product composition, degree of capitalization, and market penetration in order to adjust with changes in technology, market demand, and market

access brought about by globalization and market liberalization (Ahmed 2001, ADB 2001, USAID 2001).

No. of workers	Contribution to GDP (billion Tk)	% of contribution
1	194.00	26
2 - 5	379.66	51
6 - 10	73.12	10
11 - 20	45.18	6
21-50	33.96	5
51-100	15.14	2
<b>Total</b>	<b>741.06</b>	<b>100</b>

Source: ICG/MIDAS Survey 2003

One estimate puts the total contribution of SMEs to GDP at about Tk 741 billion in 2003 which is about a quarter of the country's total GDP in the year (Table 9). The table also shows that enterprises having two to five workers contribute more than half of the contribution made by SMEs to GDP, followed by those having only one worker (26 percent) and those having six to ten workers (10 percent). In the case of sectors, manufacturing SMEs contribute the highest proportion of 38 percent to GDP; followed by agricultural SMEs (24 percent) and SMEs in wholesale and retail trade and repair activities (23 percent) (Table 10). In this respect, cross-country figures show wide variation in the contribution of SMEs to GDP (Annex 1).

Sectors	Contribution to GDP (billion Tk)	% contribution
Agriculture	177.73	24
Fishing	32.87	4
Manufacturing	282.34	38
Construction	7.2	1
Wholesale & retail trade, and repairs	171.34	23
Hotels and restaurants	28.6	4
Transport, storage, and communication	8.95	1
Real estate, renting, and business activities	13.77	2
Education	0.15	0
Health and social work	2.74	0
Other service activities	15.63	2
<b>Total</b>	<b>741.32</b>	<b>100</b>

Source: ICG/MIDAS Survey 2004



## 5. Policies for SME Development

The experience across different countries in Asia suggests that policies for developing the SMEs are largely context-specific and can have varying effectiveness depending on country situations.

South Korea, for example, provides an example of successful SME promotion policy. During 1970s and 1980s, South Korea created a number of institutions and support mechanisms for SMEs covering state, public, and non-profit institutions. The technical support system for providing technical extension services directly to the enterprises included state agencies like National Industrial Technology Institute (NITI) and Regional Industrial Technology Institutes (RITIs). Several public research institutes were also established for serving the SME sector. On the other hand, Singapore and Taiwan pursued less targeted policies but offered comprehensive sets of government assistance programs to facilitate the SMEs to upgrade themselves, increase productivity, and improve competitiveness. Taiwan's success was built on a network approach to providing assistance in financing, production technology, management, R & D, environmental protection, and other areas. The network included various government institutions, public and private financial institutions, professional groups, and associations. Singapore offered a broad based package of assistance to SMEs under its government development assistance program using a networking approach.<sup>8</sup>

The above shows that most Asian countries, who succeeded in creating dynamic SME sector, were somewhat 'interventionists' in their SME development strategies and programs. This also shows that a wide range of policy options are available for promoting SMEs which can have varying effectiveness depending on specific situation of a country.

In the past, Bangladesh adopted a number of programs for providing financial, technical, marketing, and other assistance to SMEs involving the Bangladesh Small and Cottage Industries Corporation (BSCIC) and other organizations. However, despite the multiplicity of programs and organizations, the reach and effectiveness of these efforts remained extremely limited due to many constraints including limited budget and personnel skills, inadequate links with small producers, and absence of effective market orientation of proposed interventions. A significant constraint, moreover, is the access to finance as technology acquisition by SMEs is an expensive process and SME producers usually do not have adequate finance of their own nor do they have easy access to financial credit. This emerges as a critical disadvantage especially in cases where product design innovation is a major tool of ensuring competitiveness. Moreover, Bangladesh lacks a vision for the SME sector and a comprehensive approach to the sector that would facilitate the growth of SMEs and upgrading of small enterprises.

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<sup>8</sup> Singapore also introduced a local industry upgrading program through creating a tripartite partnership among multinational corporations (MNCs), local SMEs, and the government under which MNCs provided focused assistance to their suppliers to improve quality and operational efficiency.

## Access to finance by SMEs

As noted above, limited access to bank financing is one of the critical constraints of SMEs in Bangladesh. These enterprises have a limited scope to access the capital market for term lending as well. As such, the SMEs are almost fully dependent on either own sources of finance or to formal banking sources. Although the large enterprises have a greater capacity to raise capital (term lending) from the capital market, they still depend heavily on bank financing for term loan as well as working capital. As a result, the SMEs are somewhat crowded out from the banking sources. The share of term lending and working capital for large scale and small scale industries is given in Table 11. It shows that the share of term lending in total advances for large industries lied within a range of 88 percent and 95 percent during the last 15 years with a consequent share for small scale industries lying between 2 percent and 5 percent. Similarly, the share of working capital financing for large industries was between 90 percent and 95 percent as against the share of 3 percent and 11 percent for small scale industries.

Year	Term lending (in %)		Working capital (in %)	
	Medium & large	Small scale industry	Medium & large	Small scale industry
1992	94.80	4.12	88.03	8.44
1995	94.65	4.46	85.64	10.91
1997	94.90	4.53	87.68	10.14
1998	94.81	4.32	86.96	10.83
1999	94.86	4.63	88.83	9.11
2000	95.06	4.49	87.86	9.62
2001	94.91	4.66	89.71	8.40
2002	92.71	5.26	94.10	4.86
2003	94.26	2.58	93.56	5.15
2004	93.35	3.21	92.88	5.73
2005	90.65	2.46	94.52	4.30
2006	89.58	2.78	95.07	3.69
2007*	88.16	3.08	94.80	3.57
<b>Range</b>	<b>95.06-88.16</b>	<b>5.26-2.46</b>	<b>95.07-89.71</b>	<b>10.91-3.17</b>

*Source: Scheduled Banks Statistics (various issues)*  
*Note: Disbursement to cottage industry and service industry are not included in small scale industry*  
 \*= Up to March 2007.

In recent years, there seems to have taken place a change in the attitude of the commercial banks as reflected in higher loan disbursement to SMEs. Loan disbursement to SMEs by scheduled banks registered a growth of 5.8 percent during June 2006 to December 2007; with loan disbursement to small enterprises rising by 6.3 percent and to medium enterprises by 5.4 percent (Table 12). For ensuring smooth and efficient loan disbursement to SMEs, some private commercial banks have created special windows for them.

End period	Small enterprises	Medium enterprises	Total SMEs
June 2006	89.14	103.77	192.91
September 2006	101.17	96.64	197.81
December 2006	103.99	95.96	199.95
March 2007	99.83	90.13	189.96
June 2007	109.51	104.25	213.76
September 2007	118.10	114.09	232.19
December 2007	128.69	142.73	271.42
<b>Average Growth</b>	<b>6.34</b>	<b>5.36</b>	<b>5.81</b>

*Source: Statistics Department, Bangladesh Bank.*

### **SME refinancing by Bangladesh Bank**

In view of the limited access of SMEs to credit facilities from the formal banking system, Bangladesh Bank has opened a window of SME refinancing facilities for the commercial banks and the non-bank financial institutions (NBFIs) so that they can accommodate a larger amount of SME financing for which BB earmarked a refinance scheme fund of Tk. 3 billion which has recently been raised to Tk. 5 billion. Since its inception, banks and NBFIs have been availing the refinance scheme and till March 2008, the refinanced amount was Tk. 6.21 billion which was Tk. 1.24 billion at the end of April 2005. As against this refinanced amount, the banks and NBFIs distributed loans to 7,598 beneficiary enterprises, which were 2,192 in 2005. It may be mentioned that the banks and NBFIs are required to maintain 2 percent general provision against unclassified SME loan which has recently been reduced by BB to 1 percent.

In order to ensure a greater flow of funds to the SME sector, BB has issued some pragmatic guidelines for the banks and NBFIs. These financial institutions are required to fix yearly loan disbursement target for SMEs of which at least 40 percent should go to small enterprises and the rest to medium enterprises. In addition, dedicated desks are to be opened for small and medium entrepreneurs.

Women entrepreneurs, who are talented, courageous, and creative, have been playing a pioneering role in the SME sector, especially in agriculture, RMGs, handicrafts, furniture, and the poultry sector, despite facing many hurdles such as bureaucratic and institutional deficiencies, difficulties in accessing information relating to service facilities including institutional and marketing support, and limited access to bank finance and high lending rates in establishing and running their businesses. In order to promote women entrepreneurship, SME Foundation has constituted a forum titled 'National Women Entrepreneurs Forum (NWEF)' and commenced credit operations to provide credit to SME entrepreneurs at a low rate of interest. In order to expand the participation of women in SMEs and provide greater support to women entrepreneurs, BB has enhanced the minimum allocation under its various refinance schemes (ADB, BB, and EGBMP) from a level of 10 percent to 15 percent, of which 40 percent has been kept for women SME entrepreneurs. Apart from this, BB has taken several other measures to support women entrepreneurs:

- Banks and NBFIs have been directed to settle the loan process with highest priority within a minimum time upon receiving loan applications from women entrepreneurs.
- Each bank and NBFIs shall open ‘Women Entrepreneur’s Dedicated Desk’ (WEDD) which would be serviced preferably by female officers trained in SME financing.
- The WEDD shall provide other related services including guidance in project formulation and implementation, assistance in processing loan application, and other banking services.
- The banks and NBFIs have been advised to adopt transparent business strategy and guidelines for sanctioning loans so that loan application and selection process for women entrepreneurs becomes easy, efficient, and less time consuming.

### Equity and Entrepreneurship Fund

In order to encourage investments especially in risky but prospective agro-based, food processing and IT sector industries, the Equity and Entrepreneurship Fund (EEF) was established through budgetary allocation of the government. Initially, the government allocated Tk one billion in FY01 for EEF and BB was entrusted with the responsibility of administering the fund. Since its inception, a wide range of enterprises have availed the EEF, most of which are SMEs. The major sectors include: poultry and feed, fish hatchery, shrimp hatchery, cattle and goat feeding, meat processing, fruit processing, wood processing, and software development.

Until March 2008, a total of 247 entrepreneurs received Tk 4,677.5 million from the EEF. The disbursement to fisheries and fish cultivation sub-sector was the highest followed by software development, poultry and fish feed, grand parent hatchery, potato flask, and fruit processing. Total disbursement, however, shows a declining trend in recent years mainly due to low demands from participating banks and financial institutions (Table 13).

<b>Fiscal Year</b>	<b>Number of projects</b>	<b>Disbursed amount</b>
2001-02	2	52.0
2002-03	9	411.1
2003-04	47	521.8
2004-05	130	1,475.6
2005-06	145	1,066.4
2006-07	124	734.7
2007-08*	247	4,677.5
* Up to March 2008. Source: Bangladesh Bank		

The above developments indicate that financing from formal sources to SMEs is growing at a faster rate in recent years. Since access to finance is one of the key constraints of the SMEs, it is expected that higher flow of institutional credit would enable the SME sector to expand at a faster pace with positive impact on growth acceleration and employment generation in the country.

## **6. Conclusions and Policy Implications**

In recent years, SMEs have emerged as a new engine of growth in many developing countries; and factor endowments and development potentials show that SMEs can also play a significant role in Bangladesh in promoting its poverty reduction agenda. This has been acknowledged in the country's development and poverty reduction strategies; and policies and programs have been initiated to ensure unhindered growth of the SMEs. In this backdrop, this note has examined the growth and contribution of the SMEs to GDP and the national economy using available information.

The SMEs in Bangladesh cover different sectors (mainly livestock, fishing and poultry, industry and services) and the SMEs are growing over time. The analysis shows that during FY78-FY03, small enterprises grew by 4.6 percent per year, while medium enterprises grew by 6.4 percent during FY82-FY03. During FY03-FY06, the number of SMEs in different sectors increased by 5.2 percent. This growth matches the manufacturing sector growth and the share of small scale industries in the overall economy.

The important concern relating to the SME sector is to ensure its speedy growth in output, employment, and exports. For this, the country's industrial strategy needs to be anchored in multi-layered subcontracting arrangements between the large enterprises and the SMEs and among the SMEs themselves. In this respect, 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. For the purpose, the National Task Force has identified 11 sectors as booster sectors.<sup>9</sup> In recent years, SME-centered activities in education, health, information technology, and food processing sectors have expanded rapidly in response to higher demands and there exists more potential for their future expansion. Innovation and searching for new markets are also important for sustaining the growth of existing SMEs and flourishing of new SMEs. Infrastructural bottlenecks, especially power, gas, and transport are significant deterrents to SME expansion and these should be effectively addressed for ensuring uninterrupted growth of SMEs.

The analysis shows that SMEs have good potential of absorbing the country's expanded labor force. Employment generation grew at a yearly rate of 5.4 percent in small enterprises during 1991-2001; while it grew by 9.6 percent for the medium enterprises during 1982-2003. It is estimated that SMEs currently absorb almost 80 percent of the total employment in the industry sector and 23 percent of the country's total labor force. Since creation of decent and productive employment opportunities for the expanding labor force is the key challenge for accelerating poverty reduction in the country, SMEs provide an excellent vehicle for absorbing the labor force, especially in SMEs of different booster sectors.

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<sup>9</sup> The booster sectors are : electronics and electrical, software development, light engineering, agro-processing and related business, leather and leather goods, knitwear and ready made garments, plastics and other synthetics, health care and diagnostics, educational services, pharmaceutical/cosmetics/ toiletries and fashion-rich personal effects, wear and consumption.

In terms of contribution to GDP, the share of SMEs is growing over time. The estimates in this note put the contribution of SMEs at between 40 percent and 50 percent to total manufacturing output and between 20 percent and 25 percent to overall GDP. Labor productivity in the SMEs is found to be higher than that of large enterprises. The compulsion, however, is to further increase the labor productivity, for which sustained efforts of human capital development (training, education, and technical knowledge) are essential.

Generally, SMEs require less capital to establish and operate relative to large industries. The analysis shows that access to formal financing, especially bank financing, for SMEs has been increasing in recent years. However, despite the introduction of refinance facilities by the Bangladesh Bank, the supply of institutional finance still remains inadequate for the SMEs. Although several banks have opened special windows for catering to SME loan and some banks have introduced collateral free loan, it is important to develop and adhere to a common norm in bank-SME relationships so that the SMEs can access credit in a timely and efficient manner. Apart from catering to collateral free loans for SMEs, banks and NBFIs need to evolve and expand innovative financial product lines for SMEs to meet their diverse demands, such as raising funds through syndication and domestic factoring which have emerged as successful tools of SME financing in many countries.

Like in many East Asian countries where SMEs have played key roles in promoting rapid industrial and export growth, Bangladesh needs to adopt its own model of creating institutions and support mechanisms for SMEs covering government, private, and NGO sectors. In addition to finance, this should involve technical support system for providing technical extension services directly to the SMEs in which institutions like BSCIC, BSCIR, and other public and private sector agencies would play key roles in serving the SME sector. In order to be effective, targeting strategies can be used, such as using a system of 'special designation' to select SMEs that would receive priority in allocation of the support programs. Such special designations could include several categories such as promising SMEs program, technically advancing SMEs program, and the like. If necessary, SME sanctuaries could be established through which certain product lines would be reserved for SME production over a given period and preferential support would be given to SMEs producing import substitutes of technology-intensive imported components and products. The thrust would be to offer comprehensive sets of assistance programs to facilitate the SMEs to upgrade themselves, increase productivity, and improve competitiveness. The efforts could be built using a network approach to providing assistance in financing, production technology, management, R & D, environmental protection, and other areas. The network would include various government institutions, public and private financial institutions, professional groups, and relevant trade bodies and associations. The broad based package of assistance to SMEs could be administered under the networking approach. A local SME upgrading program could be introduced through creating a tripartite partnership among multinational corporations (MNCs), local SMEs, and the government under which MNCs would provide focused assistance to their suppliers to improve quality and operational efficiency.

The scope of work of separate SME windows/dedicated desks for catering to SME loan could be broadened to provide comprehensive SME related one stop services including financial counseling and resource availability, business development strategy and availability of support services, and marketing strategy and export linkages. If necessary, a SME training and marketing fund may be created to support training facilities and export promotion activities.

For accelerating future growth and viability of the SMEs, technological innovation and knowledge transfer, product diversification, and marketing services are the key areas where special attention are needed. The adoption of a comprehensive road map, jointly worked out for implementation through public-private collaboration, for technological and marketing services for the SMEs can go a long way in creating a competitive SME sector in the country with required export linkages.

Finally, an important issue for SME development in Bangladesh is to set a vision and adopt a pro-active SME promotion policy that would facilitate a rapid transition from traditional to relatively modern product categories along with higher capitalization and use of better production technologies. This will help up scale the existing low productivity informal SMEs and deepen their links with mainstream growth seeking activities. As such, the development of SMEs in the country calls for a re-thinking of the present nature of micro credit interventions to address the second generation issues of credit up scaling and technology diffusion necessary to create sustained impact on poverty reduction.

<b>Box 1: Definition of SMEs by different institutions/ agencies</b>		
Source	Small enterprise	Medium enterprise
Industrial Policy 1991	<ul style="list-style-type: none"> <li>• Manufacturing and services activities with fixed total investment not exceeding Tk.30 million (excluding cost of land, establishment, and transport cost of assets, tax and duty).</li> <li>• No distinction was made between small and medium enterprises.</li> </ul>	
Industrial Policy 1999	<ul style="list-style-type: none"> <li>• Enterprises employing fewer than 50 workers and/or with a fixed capital investment of less than Tk. 100 million.</li> </ul>	<ul style="list-style-type: none"> <li>• Enterprises employing between 50 and 99 workers and/of with a fixed capital investment between Tk.100 million and Tk.300 million.</li> </ul>
Industrial Policy 2005	<ul style="list-style-type: none"> <li>• Manufacturing sector: industries having fixed assets below Tk.15 million.</li> <li>• Non-manufacturing sector: enterprises which employ less than 25 laborers.</li> </ul>	<ul style="list-style-type: none"> <li>• Manufacturing sector: industries having fixed assets between Tk. 15 million and Tk.100 million.</li> <li>• Non-manufacturing sector: enterprises employing between 25 and 100 laborers.</li> </ul>
Bangladesh Bank	<ul style="list-style-type: none"> <li>• Services: Total fixed asset (TFA) Tk.50 thousand to Tk. 5 million (excluding land and building). No. of employee: less than 25 persons.</li> <li>• Trading: TFA: Tk. 50 thousand to Tk.5 million (excluding land and building). No. of employee: less than 25 persons.</li> <li>• Manufacturing: TFA: Tk.50,000 to Tk.15 million (excluding land and building). No. of employee: less than 50 persons.</li> </ul>	<ul style="list-style-type: none"> <li>• Services: TFA: Tk. 5 million to 100 million (excluding land and building). No. of employee: less than 50 persons.</li> <li>• Trading: TFA: Tk.5 million to 100 million (excluding land and building). No. of employee: less than 50 persons.</li> <li>• Manufacturing: TFA: Tk.15 million to 200 million (excluding land and building). No. of employee: less than 150 persons.</li> </ul>
BBS	<ul style="list-style-type: none"> <li>• Establishments which have fewer than 10 workers.</li> </ul>	<ul style="list-style-type: none"> <li>• Establishments which have more than 9 workers and less than 50 workers.</li> </ul>
World Bank	<ul style="list-style-type: none"> <li>• Up to 50 employees, total assets of up to USD 3 million and total sales of up to USD 3 million.</li> </ul>	<ul style="list-style-type: none"> <li>• Up to 300 employees, total assets of up to USD 15 million and total sales of up to USD 15 million.</li> </ul>
Sources: Authors' compilation.		



<b>Annex 1</b>			
<b>Contribution of SMEs selected countries</b>			
Country	SMEs as % of all enterprises	Contribution of SMEs to GDP (%)	Contribution of SMEs to employment (%)
<b><u>Asia</u></b>			
Bangladesh	80	20-25	40
India	97.6	80.0 (Ind.)	-
Pakistan	60	15	80.0 (Ind)
China	99	60	92
Japan	99.7	69.5	72.0 (M)
Hong Kong	-	-	61.5
Korea Rep.	99.7	47.5	71
Malaysia	-	15	17.0 (M)
Philippines	-	280.0(V-ad, M)	45
Singapore	-	41.0(M)	58.0 (M)
Thailand	-	47.0 (V-ad, M)	65.0 (Ind)
<b><u>OECD/EU</u></b>			
Australia	-	30	70
Canada	99.8	43	47
Finland	98.5	40	52
France	97.6	49.8	56.6
Germany	99.3	57	69.3
Italy	99.2	55	71
Sweden	99	57.0 (Total V-ad)	60
U.K.	99.1	52	55
USA	97.6	52	50.1
<b><u>Africa/Latin America</u></b>			
Brazil	99.2	60.8 (M) output	66.8
Mexico	89.7	31.1(M) output	44.6(M)
Venezuela	93.2	13.8(M) output	39.5 (M)
Egypt	90	9.0 (M) output	11.0 (M)

Source: (1) Bahar and Uddin 2007.

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