Participation of Banks in Small Enterprise Financing: Problems and Issues for Bangladesh

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ABSTRACT

The economic and social importance of the Small and Medium Enterprise (SME) sector nowadays is well acknowledged in academic and policy literature. SMEs play a very momentous role in the economy in terms of economic growth, employment creation, entrepreneur development and export earnings. Small enterprises lack access to finance due to their own constraints as well as the financial institutions' perception of high risk and high cost. This paper attempts to find out the problems encountered by small enterprises in obtaining loans from banks in Bangladesh and the major problems faced by banks while financing small enterprises. For collecting primary data from the small businesses, three hundred forty one (341) small enterprises were interviewed through the questionnaires. Survey results show that 65.39% enterprises received loans from banks, while 34.61% enterprises did not receive any loan. Small enterprises face several problems in obtaining loan from banks. It is evident that high interest rate is the most significant problem followed by excessive security and guarantee requirement, working capital requirement, complexity of documentation, non availability of loan in due time, non availability of required amount, banker's reluctance and negligence, and mal-practices of bank officials. On the other hand, 22 different categories of banks are interviewed through the questionnaire. Banks cited different problems related to small enterprise financing of which non availability of required documentation, absence of good record of transactions, bad repayment history, lack of financial capacity, lack of security and guarantee are very common. Based on the study findings, a set of policy recommendations have been formulated.

Key words: Small Enterprises, Access to Finance, Problems, Commercial Banks, Bangladesh

1. Introduction

The economic and social significance of the small enterprises (SE) is well acknowledged in different academic and policy literatures. In terms of contribution toward sustainable economic growth, employment creation, development of entrepreneurs and export earnings, SEs play a very significant role in a developing economy like Bangladesh. Ayyagari et al, (2003) in their cross country study shows that SMEs account for over 51 percent of GDP and 57 percent of employment in high income countries while the corresponding figures for low income countries are only 16 and 18 percent respectively. In advanced economies, SMEs consist of more than 98% of the total business; contribute more than 65% of total employment and more than 50% to Gross Domestic Product (GDP) and also constitute 95% of registered firms (DailyFT, 2014). SEs use local skilled and unskilled labours to develop different kinds of products and services to fulfil local needs mainly using indigenous resources. They are mostly the labor intensive businesses and in many cases are able to cover small market segments that are not covered by the larger businesses. Small businesses are also important due to their geographic location and the inclusion of women as entrepreneurs in our country.

Bangladesh economy is characterized by high population, low per capita income, high level of unemployment and underemployment, mass poverty and high income disparity. At present, the growth rate of population is 1.6% and 31.51% of total population is below the poverty line (Mundi Index 2012). On the other hand, the unemployment rate of Bangladesh is 5% and the underemployment rate is about 40% (The world Fact Book, 2014). In Bangladesh, SME sector contribute 25% to the GDP, about 40% of gross manufacturing output, account for 90% of the private sector enterprises and about 70% to 80% of the non-agricultural workforce working in the sector which is around 25% of the country's total labour force (Dhaka Tribune, 2014). In these circumstances, higher growth of SMEs which is treated as an engine for economic growth and machine for job creation can highly reduce poverty to a satisfactory level by creating employment for the skilled and unskilled manpower in this sector. According to Storey (1994), for every group of hundred small firms, the four fastest growing firms will generate half of the jobs in that group over a period of ten-year.

The underlying uniqueness of small businesses is: they are operated by a family members or close group; business owner is the main decision maker; absence of formal business records and even if some formal records are available, information may not be perfect and are rarely audited. As a result they cannot attract the formal financial sector for availing their basic financial needs.

Small enterprises need better access to finance for their growth especially for the acquisition of capital equipment and the usage of new technology for their business operations. However, their access to finance is restricted because SEs generally do not have dependable and audited balance sheet information based on which financial institutions can take their credit decision and do not have sufficient capitalization or additional assets that can be offered as collateral for qualifying the loan request. Most of the commercial banks operating in Bangladesh do not consider small businesses as part of their profit earning weapons. This is because they perceive the sector is very risky alone with incurring the high monitoring cost. Although this is true in many cases, nowadays few of them are coming forward with a good number of initiatives for serving small enterprises. But these are not adequate to fulfil the larger amount of demand. Moreover, among all the banks, most of them are financing on the behest of central bank. Thus it is recognized that SE sectors in developing economies are underserved, especially in terms of finance.

The very common challenges that SEs generally face in most of the developing countries include problems related with access to finance in the formal financial sector, some institutional, administrative and legal barriers etc. Levy (1991) highlighted some of the common problems faced by most developing and transition countries which are the financing constraints, legal and regulatory constraints, technical, marketing and other non-financial input constraints, and cost constraints.

Most of the entrepreneurs in our country are illiterate and are unable to prepare proper business plan that may help them to achieve their goal easily. Proper documentation, on the other hand, creates major problems for obtaining funds from the formal sources. Many SME linked products and services are available in different financial institutions but in many cases small businesses, especially operating in the rural areas, are not aware about these products and services. As a consequence they face severe difficulties to compete with other small business those can avail such products and services.

Many academician and the policy makers have asserted that there exists a "financing gap" for SEs. There is no commonly agreed definition of this gap, but the term is basically used to mean that a sizeable share of economically significant SEs cannot obtain financing from banks/NBFIs, capital markets or other suppliers of finance. Furthermore, it is often alleged that many entrepreneurs who do not currently have access to funds would have the capability to use those funds productively if the funds were available. But due to structural characteristics, the formal financial system does not provide finance to such entities. Given that small enterprises are responsible for significant levels of employment, innovation and productivity, it is important to be well informed about the determinants of SE growth. One important determinant is the provision of growth funding. Financial problems (lack of funds) constrain the development and growth of SEs because many SEs are unable to access the same kinds of growth funding often available to large businesses.

2. Objectives of the Study

This paper examines the present scenario of the problems related with small enterprises financing which are identified by both the small entrepreneurs and the commercial banks operating in Bangladesh. On the basis of above background, the specific objectives of the study are to:

(i) identify the problems encountered by the small enterprises in getting loans from the banks in Bangladesh.

(ii) find out the problems faced by banks in financing small enterprises and

(iii) formulate policy recommendations in addressing the challenges of small enterprise financing.

3. Literature Review

Identifying problems related to small enterprise financing is a much-debated issue. Different literatures give deeper insight into the problems of the small enterprises and the activities of the financial institutions (FIs) in coping with the problems. Some studies (EBRD 2004; Hossain 1998; PECC 2003) revealed that access to credit is one of the major obstacles for SEs mainly due to the poorly developed banking sectors in many of the developing economies. Thus, this financing problem affects the potentiality for future growth through hindering their normal business operations. In their study Beck, Demirgüç-Kunt, and Maksimovic (2005) found that lack of access to external finance is a key obstacle to firm growth, especially for SEs. Using firm-level survey data Schiffer and Weder (2001); Beck, Demirguç-Kunt, and Maksimovic (2005); and Beck, Demirgüç-Kunt, Laeven, and Maksimovic (2006) have shown that not only access to finance and the cost of credit are greater obstacles for SMEs than large firms, but also these factors are constraining for their performance more than those of the large firms.

Small entrepreneurs face several difficulties in obtaining finance from the formal sector. Haque and Mahmud (2003) reveal that, high interest rate, collateral requirement and lack of skills and attitude of bankers are among the most significant problems for small entrepreneurs in availing of finance from the formal financial institutions. Quader and Abdullah (2008) ranked high lending rate and collateral requirement as the most significant financing problem for the SEs. On the other hand, financial institutions also encounter several problems while financing small enterprises. A RAM Consultancy Services (2005) report revealed that collateral requirements, weak credit skills and practices, cumbersome loan processing and documentation were the major supply side problems in most of the Asian countries specifically in the ASEAN countries for financing SEs. In addition, Beck, Kunt & Peria (2008) revealed that banks in developing countries are less exposed to SEs, tend to provide a smaller share of investment loans, and charge higher fees and interest rates to SEs relative to banks in developed countries.

Availability of required working capital at appropriate time is another significant problem for most of the small businesses. Hossain (1998) revealed that SEs encounter great difficulties while raising fixed and working capital because of the reluctance of banks to provide loans to SEs.

Demirgüç-Kunt and Maksimovic (1998); Beck, Demirgüç-Kunt, and Maksimovic (2005), and Beck, Demirgüç-Kunt, Laeven, and Maksimovic (2006) showed that around the world informality and low quality balance sheets, lack of quality information and lack of adequate guarantees stand out as small enterprises related factors that banks perceive as impediment in serving this sector. Torre and others (2008) showed that, informality and low quality balance sheets in Argentina, lack of quality information in Chile, and lack of adequate guarantees in both countries are the SE-specific problems for which banks are reluctant to serve them. Correspondingly, Stephanou and Rodriguez (2008) pointed out some problems related with the SEs as informality, unavailability and unreliability of financial statements, low managerial capacity of owners, their family-owned nature and credit worthiness. RAM Consultant (2005) depicts that lack of information about the SEs to the lending institutions is also a great problem to ensure access to finance.

OECD (2006) study pointed out several problems on both the sides of small enterprises and financial institutions as the difficulties that SEs encounter when trying to access to financing. These are: incomplete range of financial products and services, regulatory rigidities or gaps in the legal framework, lack of information on both the bank's and the SE's side. In the same paper, the study also focused on the problems relating to the attitude of the banks particularly for the start ups and very young firms that lack a substantial amount of collateral or small firms having possibilities of high returns with a high risk of loss. Along with the finance related problems, there are some non financial problems like managerial capacity, willingness to pay, lack of motivation to grow, lack of using money efficiently etc. are associated with the small businesses.

There are many other barriers exists in this sector in different forms related to legal and administrative framework. Bakht, Zaid (1998) and Ahmad, Salahuddin et al. (1998) revealed that the policy environment within which SMEs in Bangladesh operate imposes legal, regulatory and administrative constraints. Sometimes the entrepreneurs need to procure various papers and documents to be eligible for loan and therefore they need the support from the different regulators and administrators. But in many cases they face difficulties to obtain these papers due to the cumbersome process and high time requirement.

4. Data & Methodology

The study has been conducted based on both primary and secondary data. For collecting primary data, two sets of questionnaires were developed; one for the Small Enterprises and the other one for the banks. For collecting the information from the small enterprises, five districts[4] have been selected purposively on the basis of the concentration of small enterprises mentioned in the 'SME Credit Policies and Programme 2010' by Bangladesh Bank (central bank of Bangladesh). Three hundred forty one (341) small enterprises were interviewed through the questionnaires and of them 70 (20.53%) were from manufacturing, 207 (60.70%) were from trading and 64 (18.77%) were from the service sector. While selecting clients for interview and using purposive sampling, several points were kept in mind like: i) clients were selected from the area where respective sample banks were located to match the clients opinions; ii) more emphasis was given to Dhaka and four adjacent districts; iii) both the borrower and non-borrower SEs were selected to comply with the study objectives. However, the study does not cover the SEs operating in rural areas and emphasizing on Dhaka and four of its adjacent districts.

[4] Dhaka, Narayangonj, Comilla, Narsingdi, Gazipur.

For collecting the information of different banks, a purposive sample survey was conducted through a questionnaire on 22 banks consisting of state owned commercial banks (SCB)[5], private commercial banks (PCB)[6], development financial institutions[7], foreign banks[8] operating in Bangladesh. While selecting banks for interview, emphasis was given to different categories of banks mentioned above and those who are extensively involved with small enterprise financing. Besides, both the accepted and rejected loan proposals of some particular banks were also reviewed. Published literature, research papers, different books were reviewed to complete the theoretical background and relevant websites were visited to collect secondary information.

This paper is divided into six sections. After a brief background as part of introduction (section 1), section 2 presents the objectives of the study. Section 3 discusses the methodology of the study. Section 4 highlights the current status of banks' involvement in financing SEs in Bangladesh. Section 5 analyzes the findings of survey results and finally, section 6 represents the policy recommendations and conclusions

5. Small Enterprise Financing in Bangladesh: Current Status of Banks' Participation

In Bangladesh, two definitions exist regarding SEs; one is given in 'SME Credit Policies & Programmes 2010' published by Bangladesh Bank and other is in the 'Industrial Policy 2010' published by the Ministry of Industry. Recently Bangladesh Bank has issued a circular (SMESPD, Circular No-1, 19 June, 2011) to determine the size of the SEs[9] in order to harmonize the definition with the industrial policy. It is important to note that industrial policy does not cover the definition for trading concerns. According to the definition all of the commercial banks define their SE portfolio.

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[5] *Sonali Bank Ltd., Janata Bank Ltd., Agrani Bank Ltd, Rupali Bank Ltd.*

[6] *Uttara Bank Ltd, Pubali Bank Ltd, AB Bank Ltd, National Bank Ltd, Eastern Bank Ltd, Islami Bank Bangladesh Ltd, IFIC Bank Ltd, NCC Bank Ltd, EXIM Bank Ltd, BRAC Bank Ltd, Bank Asia Ltd, Mutual Trust Bank Ltd, The City Bank Ltd, Social Islami Bank Ltd.*

[7] *Bangladesh Krishi Bank, BASIC Bank Ltd ,*

[8] *HSBC, Commercial Bank of Ceylon PLC.*

[9] According to Bangladesh Bank Circular, Small Enterprise (SE) means an entity, ideally not a public limited company, which complies with the following criteria:

Small Enterprise- A ***manufacturing concern*** with total assets at cost including installation of fixed asset and excluding land and building from Tk. 50 lac to 10 crore and/or number of employee ranges from 25 to 99. A ***service concern*** with total assets at cost including installation of fixed asset and excluding land and building from Tk. 5 lac to Tk 1 crore and/or number of employees ranges from 10 to 25. A ***trading concern*** with total assets at cost including installation of fixed asset and excluding land and building from Tk. 5 lac to Tk 1 crore and/or number of employees ranges from 10 to 25.

Note: If on one criterion, a firm falls into the 'small' category, while it falls into 'medium' category based on the other criterion, the firm will be deemed as in the 'medium' category. On the other hand, if on one criterion, a firm falls into the 'medium' category, while it falls into 'large' category based on the other criterion, the firm will be deemed as in the 'large' category.

The current status of the SME financing has been analyzed in terms of SME loan compared to total loan, targeted SME loan and achievement, segregation of SME loan in small and medium enterprises, sector-wise disbursement of SME loans by the financial institutions and disbursement of SME loan to the women entrepreneurs.

Table 1 highlights the current status of the SME outstanding loan as percentage of total loan provided by the banks and non-bank financial institutions operating in Bangladesh. Considering the banking sector, in year 2013 the percentage of SME outstanding loans to total loans by SOB's was 18.38% which decreased around 36% in compared to year 2011; SB's was 29.70% in year 2013 and increased by 43.20% from year 2011; FB's was 9.85% which was almost the similar in year 2011; and PCB's was 8.12%, which decreased by 41%. Although the percentage of SME loans to total loans stood 24.71% in year 2013 from 21.23% in year 2011, it is evident that the PCBs' performance was not good at all among the other groups in banking sector while financing SMEs. As a larger component of financial institutions in Bangladesh commercial banks should focus more to disburse SME loan for ensuring the growth of the sector.

Table- 1: Current Status of SME Loan outstanding as percentage of Total Loan (Tk. in Crore)

	2011		2012		2013	
Name of Banks/NBFIs	**SME Loan disburse-ment**	**% of SME loan to Total Loans**	**SME Loan disburse-ment**	**% of SME loan to Total Loans**	**SME Loan disburse-ment**	**% of SME loan to Total Loans**
SOB	4158.88	28.55	3941.28	18.16	5147.92	18.38
SB	2563.55	20.74	3671.79	26.36	3690.36	29.70
FB	1241.35	9.85	1579.26	8.92	1187.04	9.50
PCB	44109.72	19.82	59070.13	25.29	73411.89	8.12
Total Banks	52073.50	21.23	68262.46	22.93	83437.21	24.71
NBFIs	1645.94	12.35	1490.96	12.43	1886.04	11.36
Total Banks & NBFIs	53719.44	20.76	69753.42	22.35	85323.25	23.85

Note: SOB- State own Bank, SB- Specialized Bank, FB- Foreign Bank, PCB- Private Commercial Bank.

Source: Authors' calculation, Data: SME & Special Programmes Department, Bangladesh Bank.

Table 2 shows the segregation of SME loan into small and medium enterprises on the basis of the total SME loans disbursed by the banks and NBFIs in Bangladesh. The aggregate disbursement in small enterprises by all banks was 47.75% and by NBFIs was 60.22% in 2011. Whereas, in 2013 the disbursement in small enterprises sector stood at 51.57% for all banks and 68.02% for the NBFIs. The total disbursement in year 2013 by the financial sector in small enterprises was 51.93%. From the table it is evident that banks are lagging behind the Non-bank financial sector in financing the small enterprises compared to medium enterprises. It is also found that, the total banks and NBFIs sector gradually increase their disbursement of loan to small enterprises compared to medium enterprises from 2011 to 2013.

Table- 2: Segregation of SME Loan in Small and Medium Enterprises

Year	**2011**		**2012**		**2013**	
Banks/ NBFIs	**% of Total Disbursement**		**% of Total Disbursement**		**% of Total Disbursement**	
	Small	**Medium**	**Small**	**Medium**	**Small**	**Medium**
SOB	57.10	42.90	46.87	53.13	51.24	48.76
SB	46.44	53.56	29.12	70.88	56.01	45.99
FB	47.17	52.83	50.44	49.56	41.86	58.14
PCB	46.96	53.04	54.28	45.72	51.53	48.47
Total Banks	47.75	52.25	51.10	48.90	51.57	48.43
NBFIs	60.22	39.78	53.89	46.11	68.02	31.98
Total Banks & NBFIs	48.13	51.87	51.18	48.82	51.93	48.07

Source: Authors' calculation, Data: SME & Special Programmes Department, Bangladesh Bank.

Table 3 highlights on the sector-wise disbursement of SME loan by the banks and NBFIs in Bangladesh. The disbursement of SME loan was categorized as service sector, trading sector and manufacturing sector. Here, it is found that banking sector disbursed SME loan largely in the trading sector and least in the service sector, while NBFIs maintained more or less balanced approach compared to the banking sector in disbursing their SME loan.

The SOBs and PCBs disbursed loan in the service sector decreased in 2013 than 2011. SBs financing to the manufacturing and service sectors were increased in 2013 than 2011, while the trading sector financing had a decreasing trend. The FBs disbursement in manufacturing sector had a significant increase in 2013 compared to 2011 and the trading sector had around 12% decrease in 2013 than 2011, while service sector financing was dropped around 15%. In aggregate, the financing of all categories of banks in manufacturing sector was decreased in 2013 compared to 2011, while the trading sector disbursement had almost the similar percentage which is around 67% in year 2013 and 2011.

Table- 3: Sector-wise Disbursement of SME Loan

	2011			2012			2013		
Name of Banks/NBFIs	**% to Service Sector**	**% to Trading Sector**	**% to Mfg. Sector**	**% to Service Sector**	**% to Trading Sector**	**% to Mfg. Sector**	**% to Service Sector**	**% to Trading Sector**	**% to Mfg. Sector**
SOB	3.94	60.67	35.39	1.79	60.86	37.35	3.38	82.30	14.32
SB	2. 41	52.21	45.37	4.29	57.71	38.00	6.04	43.02	50.94
FCB	15.00	48.59	36.41	9.44	49.71	40.85	12.68	42.89	44.43
PCB	6.56	68.82	24.61	4.96	64.81	30.23	4.95	67.46	27.57
Total Banks	6.35	66.87	26.78	4.84	63.85	31.31	5.02	66.95	28.03
NBFIs	25.67	43.70	30.63	21.79	42.68	35.53	22.13	44.67	33.20
Total Banks & NBFIs	6.94	66.16	26.90	5.20	63.40	31.40	5.39	66.46	28.14

Source: Authors' calculation, Data: SME & Special Programmes Department, Bangladesh Bank.

It is also evident that, trading sector is getting more finance from the banks and NBFIs. If the banks and NBFIs do not reallocate their funds for the manufacturing sector then the productive sector would not develop. Bangladesh is at present largely engaged in the manufacturing of common consumer goods, requiring rather simple technologies that are predominantly labour-intensive and that do not require a very high degree of skills to produce. Thus, increasing financial access to SME manufacturing can ensure the better growth for future.

According to the SME & Special Programmes Department (as on December 2013) of Bangladesh Bank, total target to disburse SE loan by the financial sector was set for Tk. 41034.65 crore while the achievement was around 108%. It may be mentioned here that the targets were jointly set by the individual banks in consultation with the SME & Special Programmes Department of Bangladesh Bank.

Women entrepreneurs are coming forward by establishing SMEs and they are desperately seeking financial assistance from the formal financial institutions. But the contribution of formal financial institutions in financing women entrepreneurs are not that much significant. According to the SME & Special Programmes Department of Bangladesh Bank, the entire banking sector disbursed Tk. 3351.17 crore in year 2013 to the women entrepreneurs, which is only 3.93% of the total SME loan disbursement. It would be a worthy contribution to the society and to women entrepreneurs if the banks can disburse more SME loan to them.

Currently banks and financial institutions are coming forward to provide finance to the small enterprise sector. Different initiatives[10] have already been taken and practiced by the financial institutions in order to facilitate the small enterprise financing mostly at the behest of Bangladesh Bank. Mamun, Hossain and Mizan (2012) identified some of the initiatives by the banks, such as: *Separate SME division, SME units/centers and dedicated desk; Separate SME dedicated desk for women entrepreneurs; Separate monitoring team for SME; Separate team for selling loan and collecting deposit through SME products; Special credit risk management team for SME banking; Different trainings for SME officials as well as for entrepreneurs; Commission/incentives based on the performances of direct sales team; Dedicated collection team for SME loan; Customized products and services for SME; Establishment of SME/Krishi Branch; Delegate loan authority to the branch managers and head of SME up to a certain limit for quicker decision; 24 hours call center and doorstep banking; Organizing SME service fortnight in every years; Develop clusters under area approach et*

6. Findings and Analysis of Survey Results

To comply with the objectives, the study tried to identify small enterprises access to credit in banks, problems faced both by them and banks through the questionnaire survey. The following sub-sections furnish the survey results with the relevant analysis:

6.1 *Small Enterprises' Access to Credit in Banks*

In this study, a sample survey was conducted on 341 small enterprises consisting of manufacturing, trading and service concerns. The survey result (Table-4) showed that 65.39%

[10] Every initiative may not applicable for all FIs

enterprises received loans from banks, while 34.61% enterprises did not receive any loan. Out of those enterprises who received loan, 54.34% enterprises received the full amount they had applied for and the other 45.66% enterprises received a part of their total requirement. Among the enterprises who received loans from banks, 72.61% enterprises were satisfied in terms of loan covenants and bank's services.

Table 4: Access to Credit in Banks

Parameters	*Number*	*Access*	*No Access*[11]	*Did not Apply*	*Applied but Denied*
Total sample	**341 (100%)**	**223 (65.39%)**	**118 (34.61%)**	**73 (61.86%)**	**45 (38.14%)**
Manufacturing	70 (20.53%)	59 (26.45%)	11 (9.32%)	4 (5.48%)	7 (63.64%)
Trading	207 (60.70%)	143 (64.12%)	64 (54.23%)	40 (54.79%)	24 (70.32%)
Service	64 (18.77%)	21 (9.42%)	43 (36.44%)	29 (39.73%)	14 (48.84%)

Source: Authors' calculation based on survey questionnaire

In comparison to the previous study (Mamun et. al., 2012), current study finds the greater access to finance in banks. Based on a sample survey for 509 small enterprises their survey result showed that 60.31% enterprises received loans from banks and other financial institutions, while 39.69% enterprises did not receive any loan from the formal financial institutions. But current study finds that 65.39% small enterprises got the access and 34.61% did not get their access. The reason behind the improvement of the access may be the fact that this study focuses only the banks as the formal financial sector and the survey was conducted on Dhaka district and some adjacent area of the same district.

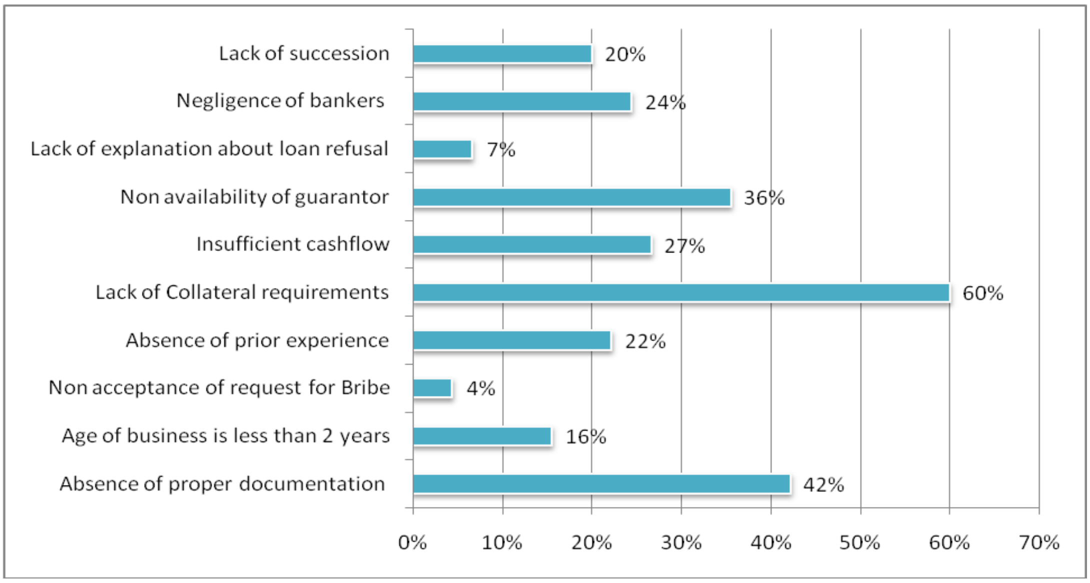
On the other hand, Choudhury & Raihan (2000) conducted a survey on SME access to credit under Structural Adjustment Participatory Review Initiative (SAPRI) study where they found that, "the access to formal credit is not available at all to 50.53 percent of the stakeholders. Only 35.79 percent of SME stakeholders enjoy unrestricted access to the formal credit. The rest (13.68 percent) of them have restricted access to the formal credit". Thus the current study evidence that day by day the small enterprises access to the formal credit is improving both for the awareness of the customers and the eagerness of the banks as well as some regulatory compulsions of the country.

From the survey it is found that 34.61% enterprises did not receive any loan from banks. Out of the total enterprises who did not receive loan, 61.86% enterprises did not apply for any

[11] Includes the small enterprises that did not apply for the loan.

loan as they were carrying on their business with their own finance and borrowing from other informal sources like family, relatives and friends. On the other hand, 38.14% enterprises applied for the loan but they were rejected. There were several reasons behind the rejection of loan by banks which are shown in Figure 1.

Figure 1: Reasons for rejection of Loan by Banks (Mixed Response)



Source: Authors' calculation based on survey questionnaire

6.2 Major Problems Faced by Small Enterprises

In the survey, the entrepreneurs identified some major problems in obtaining credit form the banks as shown in Table – 5. It is evident that high interest rate is the most significant problem followed by excessive security and guarantee requirement, working capital requirement, complexity of documentation, non availability of loan in due time, non availability of required amount, banker's reluctance and negligence, and mal-practices of bank officials. However, Choudhury & Raihan (2000) conducted a similar survey on SME access to credit and found some different results as barriers for access to credit. In their survey they identified collateral as the prime barrier followed by bribe, delays, high interest rate, banker's disinterest etc.

From the survey it is evident that about 90.62 percent entrepreneurs claimed existing interest rate is high. They also informed that many banks impose different service charges and processing fees in addition to existing interest rate which ultimately increase their effective rate of interest. At present the interest rate of commercial banks for SEs ranges from 15 to 18 percent. However, the respondents' preferred average rate of bank interest is 10.35%. They argued that due to the existing high interest rate the cost of doing business has increased tremendously which have a negative impact on their regular business performances.

Table 5: Major Obstacles Cited by Small Entrepreneurs in Obtaining Bank Credit (Multiple Responses)

Sl.	Major Obstacle	Responses (%)
1	High interest rate	90.62
2	Excessive security and guarantee requirement	63.84
3	Complexity of documentation	59.23
4	Non availability of loan in due time	47.36
5	Non availability of required amount	34.81
6	Banker's reluctance and negligence	16.41
7	Malpractices of banks' officials	12.72

Source: Authors' calculation based on survey questionnaire

The survey results show that 63.84 % of the respondents opined that excessive security and guarantee requirement is the real problem for obtaining loan from banks. According to the respondents, banks usually accept collateral in the form of real property, products or valuable assets rather than balance of a checking account, finished commodity, guarantees of another company or a bank and securities as collateral. In few cases, it was found that some banks do not have any loan product which is collateral free. As a result, the SEs pointed that excessive collateral requirements by the banks create a barrier for getting loan from the banks in Bangladesh.

Small enterprises are facing problems in collecting the documents required for loan processing. From the survey it is found that 59.23% SEs claimed documentation as the obstacle for accessing finance from the banks. During the interviews some of the entrepreneurs mentioned that for the lack of some documents (*RS problems created by surveyor, property related documents, bank statements, deed of business, rental agreement with the house owner, TIN and VAT registration certificate, environment clearance certificate etc*) they are not getting finance from the banks. Moreover, the respondent claimed that they face a lot of problems while getting documents from different issuing authorities.

During the survey 47.36% SEs complained that they are not getting loan in due time due to the long loan processing time of some banks. In SE financing, a few of the commercial banks in Bangladesh have reduced the loan processing time to one weak or less than that. But still most of the banks need more than 15 days to process a loan even it requires a month in some cases. But the enterprises preferred loan processing time is 10.31 days. The study results showed that 34.81% SEs do not get loan amount as they required. As a result SEs face difficulties in doing the business and expanding them towards the desired level. This happens in case of term loan as well as in working capital loans.

From the survey result 16.41% SEs claimed that some of the banks are reluctant to provide loan to the small enterprises. This causes a problem for the small enterprise to get access to bank credit both in urban and rural areas. The bankers prefer to deal with the large or medium enterprise financing rather than SEs due to some inherent benefit of loan administration and monitoring of the large or medium enterprises. Moreover 12.72% respondents claimed that Some of the bank officials are engaged in malpractices while sanctioning loan that hinder small enterprises to have access in the formal credit. They also claimed that some bank officials demanded extra money other than the stipulated fees or charges in order to get the required loan amount which they called bribe.

6.3 Major Problems Faced by Banks

Commercial banks are playing significant role in financing small enterprises although in some extent they are reluctant to disburse the SE loan. The increased involvement of the banks in financing small enterprises is mainly due to the central bank's policy initiatives and directives. Previous section highlighted several problems of the small enterprises for their access to finance from banks. To identify the problems faced by banks, the study conducted another survey cantering the banks that are supplying the funds to the small enterprises. The banks cited different problems related to small enterprise financing of which major problems are summarized in Table- 6.

Documentation requirements sometimes hinder small enterprises to get access to the formal financial sector. The survey indicated that 78.17% of the bankers endorsed non-availability of documents is the most significant barrier to ensure access to formal credit for the small enterprises. In addition to that they put certain comments on different documents required for approving a loan proposal. Such as in the rural areas the businesses are operating without trade license and other certificates required. Again the businesses do not have the TIN (Tax Identification Number) and Vat Registration Certificate. Lack of Knowledge among the borrowers makes it difficult for the bankers to process the loan in short time. The consequences all these problems is lower access to credit.

Table 6: Major Problems Faced by Banks in Financing Small Enterprises (Multiple Responses)

Sl.	Major Problems	Responses (%)
1	Non availability of required documents	78.17
2	Absence of good transaction record with bank	71.62
3	Problems linked with business address	63.59
4	Bad repayment history	56.41
5	Lack of financial capacity	53.16
6	Inadequate net worth	47.82
7	Lack of security and guarantee	42.86
8	Minimum experience in business	36.33
9	Lack of managerial quality	34.21
10	Unstructured financial information	29.76

Source: Authors' calculation based on survey questionnaire

In the context of Bangladesh the banks do not provide finance to the small enterprises if bankers cannot find a past relationship of the enterprises with a bank. Presence of good transaction records provides a basis to the bankers to get a good idea about the cash-flow pattern of a business and which is very important for the bankers from the credit risk perspective. So, prior relationship with banks is a prerequisite to get finance from a bank. So, absence of banking relationships hinders the enterprises in getting formal finance. 71.62% of the responses support that this is a great problem to be reduced for enhancing better access to formal credit. Mostly in the urban areas of Bangladesh the small entrepreneurs are doing business at the addresses far away from their permanent address. As a result financing these enterprises makes the banks vulnerable towards fraud due the easy entry and exit character of the small business. Among the respondents 63.59% believe that they cannot provide credit because of the address problem of the entrepreneurs. Sometimes it becomes very difficult for the relationship officers to locate the entrepreneurs as they live in rented homes which can be easily shifted. This creates difficulty for the bankers into extend credit to the small enterprises.

Survey result showed that 56.41% respondents do not have interest to provide loan due the bad repayment history of SEs. Sometimes the small entrepreneurs who apply for loans carry bad repayment history although the business seems to be profitable and prospective. In those cases the bankers cannot provide finance because the person/s behind the business is most important to get the money back specifically for the small enterprises. In credit appraisal framework financial capacity of a business is the most important criteria as the bankers have the most interest on the financial ability. During the survey, about 53.16% of the bankers pointed that low financial capacity of repayment creates barrier in providing finance to the small enterprises although the entrepreneurs remain very optimistic about their businesses. Amount of net worth of a business indicates the shock absorption capacity of a business. This is particularly applicable for the small enterprises doing business where shocks can come from any corner of the market. In a large number of cases the banks cannot provide finance to the small enterprises because of shortage in net-worth although the business may be a good one. From the survey it was found that 47.82% of the opined think that due to insufficient net-worth they cannot provide sufficient credit to the small enterprises.

From the conversations with the bankers it was found that the bankers feel comfort in sanctioning loans to those clients who can provide sufficient collateral. It is true that collateral provides mental cushion to the credit people of the commercial banks. But most of the small enterprises do not have sufficient assets to be used as collaterals against borrowings from the banks. This is why the bankers sometimes show reluctances in providing credit to the small enterprises. This fact has been properly reflected in the survey, as 42.86% response supports security and guarantee as problem in providing credit facilities to the small enterprises. It important to mention that, the BB has allowed banks to provide collateral free credit of Tk 2500000 to the small and medium enterprises especially to the women entrepreneurs.

During the survey the respondents pointed that they do not provide loans to the entrepreneurs who do not have any experience related to the business. Because they feel that the inexperience of the business person will lead to loan to non-performing status. 36.33% of the responded opined in favour of inexperience as problem. The survey indicated that the respondents repeatedly provided emphasis on the managerial qualities of the entrepreneurs especially in case of small enterprises in ensuring repayment of loans. About 34% of the respondents pointed that if they find inefficiency in the management of an enterprise they do not provide loan to them. The survey interestingly found that the unstructured financial data is one of the major problems faced by the bankers in financing the small enterprises. About 30% of the respondents indicated that they do not get proper financial records and statements from the small enterprises during credit appraisal which hinders proper assessment of the financial performance of a business. The respondents also pointed that sometimes the entrepreneurs provide false financial information to get the loans.

7. Policy Recommendations and Conclusions

The study conducted a primary survey both on small enterprises and banks to point out the problems faced by small enterprises while obtaining finance from banks and the problems cited by banks in financing SEs. Based on the observations and findings, to reduce the problems of both the sides, we recommend the following:

i) High interest rate has been pointed out as one of the prime barriers by the SEs and hinders their regular business growth especially for lack of external finance. Although small enterprises claimed that the prevailing interest rate is high but in comparison to the informal money lenders and their cost of funds the rate is not so high. Even though, banks may take several initiatives to reduce such rate by searching for low cost funds. Therefore, Bangladesh Bank, Government and other stakeholders should intensify their efforts (refinancing and pre-financing) to provide low cost funds to the commercial banks. In addition, banks may offer lower interest rate to the borrowers who have willingness to accept a collateralized loan contract relative to unsecured loans.

ii) Banks may follow the Bangladesh Bank guidelines and instructions for collateral free loan in financing SEs. To reduce the excessive collateral requirements, banks can finance the SEs where personal guarantee is strong and the project has good future prospects. Moreover, FIs can concentrate on finding collateral substitute such as cash flow based lending, extensive monitoring, social security etc.

iii) Small enterprises must understand the documentation requirements of banks. To address the problems of getting documents from different issuing authorities, government and other relevant authorities can ease the documents-obtaining process by establishing separate counter for the SE clients in various departments across the country. This initiative will help the entrepreneur to meet the documentation requirements of the financial institutions.

iv) To ensure the availability of loan in due time, relationship official should provide the prospective borrower a check list in the first interaction so that the borrower might clearly visualize all the loan requirements. Moreover, Long loan processing time may be reduced by adopting standard loan approving procedures based on information technology and maintaining better information management.

v) To address the issue of banker's reluctance and negligence in dealing with the SEs, banker should have good customer relationship, positive and caring attitude towards the small entrepreneurs. The bankers have to nourish the small entrepreneurs to become successful. This relationship should be like partnership. On the other hand, against the issue of *malpractices* (taking bribe, nepotism etc.) in sanctioning loan to small enterprises, the banks have to adopt better internal control and governance mechanism to identify such activities, and if found, involved officials must get exemplary punishment.

vi) To eliminate the problem of Unstructured financial information, business owners should be encouraged to use proper accounting records on their business transactions by educating them to know the benefit of accounting and financial information, by giving them incentives such as tax holidays and easier access to bank loans, and by setting up simple SEs accounting standards. Not only the banks but also the other stakeholders such as SME Foundation, National Association of Small and Cottage Industries of Bangladesh (NASCIB), and different business bodies can organize training activity to educate the SEs in recording business transactions and preparation of structured financial statements.

vii) To address the issue, lack of managerial quality of the small entrepreneurs, government as well as the other stakeholders can take capacity building projects and impart quality training to the small entrepreneurs. This may help the entrepreneurs to manage their businesses more efficiently and become sustainable. In addition to that banks can provide different support services to the small entrepreneurs for better management of their businesses, such as: consultancy services, counselling etc.

viii) Government and trade associations may initiate building a good relationship between businessmen and bankers by participating in discussions, seminars, and symposiums. By developing a close and good relationship among these players, each side will understand and be able to sensitize the problems and constraints of the other side. This is may be the best way to reduce lack of understanding about banking procedures by the businessmen and use of onerous and unfriendly banking procedures on the part of banks in making loans to small business.

The small enterprises are the major contributor in the GDP of Bangladesh. So ensuring access to formal credit is a matter of immense importance to achieve the targeted growth of GDP. But due to certain problems of the small enterprises derived from the basic characteristics of SEs, it has become difficult for the formal financial institutions to extend credit facilities to the SEs. The major problems include lack of proper documentation, insufficient net-worth and collateral, unstructured financial information etc. On the other hand, the formal financial institutions also have limitations like long loan processing time, high interest rate, reluctance to deal with the small enterprises etc. Thus, adoption of the above recommendations may ensure a better access to formal credit for the small enterprises and can contribute higher in the economic growth of the country.

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