



Performance Evaluation of SMEs of Bangladesh

Kashfia Ahmed

Department of Business Administration, East West University

43 Mohakhali C/A, Dhaka -1212, Bangladesh

Tel: 880-2-9882-308 Ext – 186 E-mail: kashfia_ahmed@hotmail.com

Tanbir Ahmed Chowdhury

Department of Business Administration, East West University

43 Mohakhali C/A, Dhaka -1212, Bangladesh

Tel: 880-2-9882-308 Ext – 244 E-mail: tanbir@ewubd.edu

Abstract

In the context of Bangladesh, the development of Small and Medium Enterprises (SMEs) can be considered as a vital instrument for poverty alleviation and ensure the rapid industrialization. In this paper the authors have tried to identify the problems of SMEs of Bangladesh. The performance of SMEs of Bangladesh especially in terms of employee turnover rate, quality assurance, allocation of funds, marketing activities have been found significantly below the international standard. The sector gets negligible support from government. The rate of development of SME is not up to the expectation. In order to overcome the problems a few suggestions for the development of SMEs are given by the authors.

Keywords: SME, Finance, Employee, Capital

1. An overview of SME

1.1 SME: around the world

According to the European Union (2003) SMEs are defined as enterprises which have at most 250 employees and an annual turnover not exceeding 50 million Euros. Further there is the distinction of small enterprises — they have fewer than 50 staff members and less than 10 million Euros turnover — and micro-enterprises (less than 10 persons and 2 million Euros turnover).

According to the World Bank (2006) medium enterprises are defined as enterprises which have at most 300 employees and an annual turnover not exceeding 15 million US dollars. Further there is the distinction of small enterprises — they have fewer than 50 staff members and up to 3 million US dollars turnover — and micro-enterprises have up to 10 persons and \$100,000 turnover.

In the UK, sections 382 and 465 of the Companies Act 2006 define a SME for the purpose of accounting requirements. According to this a small company is one that has a turnover of not more than £5.6 million, a balance sheet total of not more than £2.8 million and not more than 50 employees. A medium-sized company has a turnover of not more than £22.8 million, a balance sheet total of not more than £11.4 million and not more than 250 employees. It is worth noting that even within the UK this definition is not universally applied.

In the USA, the definition of small business is set by a government department called the Small Business Administration (SBA) Size Standards Office. The SBA uses the term “size standards” to indicate the largest a concern can be in order to still be considered a small business, and therefore able to benefit from small business targeted funding. The concern cannot be dominant in its field, on a national basis. It must also be independently owned and operated. Unlike the UK and the European Union which have simple definitions applied to all industries, the US has chosen to set size standards for each individual NAICS coded industry. This variation is intended to reflect industry differences in a better way. The most common size standards are

500 employees for most manufacturing and mining industries

100 employees for wholesale trade industries

\$6 million of annual receipts for most retail and service industries

\$28.5 million of annual receipts for most general & heavy construction industries

\$12 million of receipts for all special trade contractors

\$0.75 million of receipts for most agricultural industries

Breaking down the SME definition, Industry Canada defines a small business as one that has fewer than 100 employees (if the business is a goods-producing business) or fewer than 50 employees (if the business is a service-based business). A firm that has more employees than these cut-offs but fewer than 500 employees is classified as a medium-sized business. (www.about.com)

In India the Small Scale Industries (SSIs) are industrial undertaking in which the investment in fixed assets in plant and machinery, whether held on ownership terms or on lease or by hire purchase does not exceed Rs. 10 million. The Small Scale Service And Business (Industry related) Enterprises (SSSBs) are industry related service and business enterprises with investment in fixed assets, excluding land and building up to Ps. 1 million. (Ministry of trade and Industry, Government of India)

According to the SME bank of Pakistan, SME means an entity, ideally not a public limited company, which does not employ more than 205 persons (if it is manufacturing concern) and 50 persons (if it is trading/service concern) and also fulfils the following criteria of either 'a' and 'c' and 'c' or 'b' and 'c' as relevant; (a) A trading/service concern with total assets at cost excluding land and buildings up to Rs 50 million. (b) A manufacturing concern with total assets at excluding land and buildings up to Rs 100 million. (c) Any concern (trading, service or manufacturing) with net sales not exceeding Rs 300 million as per latest financial statements.

1.2 SME in Bangladesh

Different countries and organizations define SME differently. The Government of Bangladesh has categorized SME into two broad classes

Manufacturing enterprise

Non Manufacturing activities

1.2.1 Manufacturing enterprise

Manufacturing enterprises can be divided into two categories;

Small enterprise : an enterprise would be treated as small if, in current market prices, the replacement cost of plant, machinery and other parts/components, fixtures, support utility, and associated technical services by way of capitalized costs (of turn-key consultancy services, for example), etc, excluding land and building, were to up to Tk. 15 million;

Medium enterprise : an enterprise would be treated as medium if, in current market prices, the replacement cost of plant, machinery and other parts/components, fixtures, support utility, and associated technical services by way of capitalized costs (of turn-key consultancy services, for example), etc, excluding land and building, were to up to Tk. 100 million;

1.2.2 Non-manufacturing activities (such as trading or other services)

Non-manufacturing activities can be divided into two categories;

Small enterprise: an enterprise should be treated as small if it has less than 25 workers, in full-time equivalents;

Medium enterprise: an enterprise should be treated as small if it has between 25 and 100 employees.

According to Bangladesh Bureau of Statistics different enterprises are defined as;

	<u>No. of employees</u>
Micro	0-9
Small	10-49
Medium	50-99
Large	Above 99

The Ministry of Industries, Government of Bangladesh has been identified following 11 booster sectors;

Electronics and electrical

Software-development

Light engineering and metal-working

Agro-processing/agro-business/plantation agriculture/ specialist farming/tissue-culture

Leather-making and leather goods

Knitwear and ready-made garments

Plastics and other synthetics

Healthcare & diagnostics

Educational services

10) Pharmaceuticals/cosmetics/toiletries

11) Fashion-rich personal effects, wear and consumption goods.

2. Review of Literature

With respect to the SME sector of Bangladesh, foreign and national experts undertook some studies. Some of the notable ones are; Uddin (2008), Chowdhury (2007), Miah (2007), Ahmed (2006), MIDAS (2004), ICG (2003), Hallberg (2002).

Uddin (2008) has stated that the economic efficiency and overall performance of the SMEs especially in the developing countries are considerably dependent upon macroeconomic policy environment and specific promotion policies pursued for their benefit.

Chowdhury (2007) highlighted that in context of Bangladesh SME is characterized by Low capitalization and limited assets, geographical diversity and high mortality, poor credit knowledge, very limited access to formal source of credit, cash intensity in transactions, very limited record keeping habit, poor financial disclosure on account of tax issues, high risk perception has led to high borrowing costs.

In a study about SME sector of Bangladesh Miah (2007) stated that the major constraints for SMEs are lack of adequate investment, lack of modern technology, high rate of interest on bank loans, irregular/inadequate supply of power, poor physical infrastructure and high transportation cost, poor information about market opportunities and requirements, inadequate availability of raw materials, lack of skilled technicians and workers, lack of research & development facilities, fierce competition, absence of effective and transparent legal system, difficulties in accessing technology, credit constraints, low access to business services, constraint of quality of human resources, low awareness, low lobbying capacity, rapid changes in policy environment.

Ahmed (2006) observed that availability of finance is a major constraint to formation and growth of SMEs in Bangladesh. Banks are reluctant to expand their SME credit portfolio because they do not consider SME lending an attractive and profitable undertaking. This is so because SMEs are regarded as high risk borrowers because of their low capitalization, insufficient assets and their inability to comply with collateral requirements of the banks. Administrative costs are also higher because close monitoring and supervision the SME operation becomes necessary.

A study (2004) by Micro Industries Development Assistance and Services (MIDAS) revealed that sources of finance are mostly friends and family member in case of SME. MIDAS tried to identify the sources of funds of SMEs. These are:

<u>Sources of funds</u>	<u>Percentage of finance</u>
Informal sector	41%
Family members	20% (interest free)
4% (with interest)	
NGO	17%
Bank	18%

According to Hallberg (2002), a stable macro-economy, an open trade and investment regime, and a competitive financial sector are argued to be most essential ingredients for a vibrant private sector. But with a law and order situation below the optimum level, corruption well above the level of acceptance and unstable political situation, the domestic environment of Bangladesh does not come to any help, rather hinders the prosperity of SME in this country.

3. Objectives of the Study

In this paper we have tried to identify the factors that influence the development and growth of the SME sector of Bangladesh. Thus the specific objectives of the study are as follows:

To appraise the present situation of SME in Bangladesh.

To identify the problems of SME in Bangladesh.

To recommend solutions to overcome the problems.

4. Methodology

This is basically a desk research. Most of the data has been collected from secondary sources. So the researchers work has been based on published information and data available in any form such as books, journals, magazines, newspapers etc. devoted to SME sector. Secondary information has been collected from Ministry of Industries, SME foundation, Bangladesh Bureau of Statistics, MIDAS, Financial Institutions and from other SME related organizations. Relevant

articles and literature in this context has also consulted. In this article we have analyzed the data of last six years of SMEs of Bangladesh. We have tried to analyze the performances of SMEs by applying simple statistical analysis i.e., growth percentage, average etc.

5. Present Scenario of SME

In 2003 the International Consultancy Group (ICG) of the UK, in collaboration with the Micro Industries Development Assistance and Services (MIDAS), conducted the National Private Sector Survey of Enterprises in Bangladesh. The survey results drew the conclusion that there were approximately 6 million Small and Medium Enterprises (SMEs), which included enterprises with up to 100 workers employing a total of 31 million people, equivalent to 40 per cent of the population of the country of age 15 years and above. The survey also found that the industrial structure of SMEs consisted of primarily wholesale and retail trade and repairs (40 per cent), production and sale of agricultural goods (22 per cent), services (15 per cent), and manufacturing only (14 per cent). Thus the survey brought out the fact that the large untapped potential for expansion in manufacture and production could be exploited (or contributing more significantly to the national economy. Another vital findings of the survey under discussion was that SMEs contributed BDT 741 (\$ 12.5) billion i.e. nearly 25 per cent of the GDP (BDT 2,996 billion) in 2003. It is reflected from this survey that enterprises employing 2-5 workers contribute 51 percent share of the total SME contribution to the economy, followed by 26 percent by those having only one worker and 10 per cent by those having 6-10 workers. For LDCs like Bangladesh, SMEs are a highly cost-effective route for industrial development.

It is observed from Table-1 that micro enterprises run by up to 10 workers contribute the most which is 86% of the total contribution from SMEs to GDP of Bangladesh. It is also observed that micro enterprises run by more than 21 workers contribute about 7% of total contribution from SME to GDP of Bangladesh.

Table-2 provides the information regarding sector wise contribution of SMEs to GDP. It is reflected from the table that manufacturing sector contributes the highest contribution in GDP i.e., 38%. It is also observed from the table that agriculture and wholesale and retail sector contribute more than 22 percent in the GDP of Bangladesh.

Table-3 shows the growth pattern of SME. It is observed that during 2001-2002 to 2004-2005 in every financial year the growth rate of SME is about 7%. In 2005-2006 the growth rate was 9.21%. The highest growth was in 2006-2007 i.e., 10.28%

Table-4 shows the growth pattern of manufacturing sector. It is observed that the average growth during 1972 to 2005 was 6.4%. During 2001-2002 to 2006-2007 the highest growth was in year 2006-07 i.e., 11.19%. It is also observed that during 2002-2003 to 2005-2006 in every financial year the growth of manufacturing sector was more than 6%.

6. Problems

At present SME sector is facing a lot of problems in Bangladesh. Some major problems are as follows;

6.1 Resource scarcity

In Bangladesh scarcity of raw materials hinder the ability of SME to be export oriented and limits its ability to reach more advanced stages of international business.

6.2 High employee turnover

Due to limited growth of SME most of the skilled employees leave SMEs. Levy (2003) observed that SMEs are knowledge creators but poor at knowledge retention.

6.3 Absence of modern technology

One of the main barriers for the development of SME in Bangladesh is inadequate technologies. Many SMEs have failed to adopt modern technology.

6.4 Poor physical infrastructure

Inadequate supply of necessary utilities like electricity, water, roads and highways hinder the growth of SME sector. Moreover unfavorable geographical conditions increase the transportation cost.

6.5 Financial constraints

Availability of finance hinders the growth of SMEs in Bangladesh. Bangladeshi bank considers SMEs as high risk borrowers because of their inability to comply with the bank's collateral requirements. Only about 15-20% of the owners of SMEs own any immovable property. Bankers issue loan on the basis of ownership of immovable property as collateral risk. As a result it automatically excludes rest 80% SME's from the list of privileged clients of the banks. Whatever collateral SME's can manage gets used up in talking the term loan leaving them with no means to seek working capital loans from banks. Because of low access to institutional financing SME's rely on inefficient financing services from informal sources.

6.6 Lack of uniform definition

In Bangladesh the definition of SME has changed overtime in different industrial policy announced by the government in different year. Absence of uniform definition makes the formulation and implementation of SME policy difficult.

6.7 Lack of information

Miah (2006) has observed that SMEs have very limited use of information technology (IT). Accounting package is used by 1-2% of the SMEs. The use of computers is revealed by say 15% of the SMEs, while the use of the Internet for business purposes applies to say 8-10% of SMEs.

6.8 Lack of entrepreneurship skills

Conservative attitude towards risk, lack of vision, ability to make plan and implementing those hinder the growth of SME in Bangladesh.

6.9 Participation of women entrepreneurs

Equality of opportunity is a major problem for SME. Female entrepreneurs are treated discriminately. They are not well represented in business organization. Government does not provide adequate institutional assistance for women entrepreneurs.

6.10 Access to Market and lack of awareness regarding the importance of marketing tool

For SME, owing a retail space is very expensive in the major cities in Bangladesh. As a result many customers are not interested to buy products and services from SMEs. Because they can't judge the quality until they physically examined the product.

Most of the cases SMEs in Bangladesh are not able to use the Integrated Marketing Communication (IMC) tools. But these tools play the role of important stimulus to motivate the customers and retain them. The country does not have enough marketing capability and resources to invest in marketing.

6.11 Bureaucracy

Wang (1995) observed that the inadequate government supports are top ranking constraints for SMEs. Unnecessary layers of Bureaucracy and red-taps reduce the competitiveness of SME and raising the cost of transactions and operations.

6.12 Absence of transparent legal system

The absence of an effective and transparent legal system discourages SMEs in exploring into risky ventures of business. There are a number of unnecessary formal requirements to start and run business that create high compliance costs and become barriers to SME development, growth and market entry.

6.13 Lack of commitment to innovation and customer satisfaction

Ernesto (2005) stated that to keep in pace with international competition, firms of all size are challenged to improve and innovate their products processes constantly. But in Bangladesh SMEs are still not relating the importance of satisfying and retaining customers by offering novel and desired benefits.

6.14 Lack of quality assurance

Govt. has failed to frame a national quality policy, provide adequate support systems and establish a national quality certification authority. As a consequence SME of Bangladesh has failed to ensure the quality of their products and services both in local and international market.

6.15 Lack of research and development facilities

It is observed that investment in R&D is still negligible in.

6.16 Fierce competition with the cheaper foreign goods

Fierce competition with the cheaper goods of China, Taiwan, Korea, India, and Thailand also pose threat to SME in Bangladesh.

7. Suggestions

In order to overcome the above mentioned problems the following suggestions are recommended;

7.1 Government must have to take adequate measures to ensure the uninterrupted supply of raw materials for SME.

7.2 Government needs to take appropriate measures to fix the minimum salary/wages of the employees of SME. That will help to minimize the employee turnover.

7.3 Government and financial institution may provide adequate finance for modernization and technological advancement.

7.4 Development of infrastructure is essential for the optimum growth of SME. So government of Bangladesh needs to take appropriate policy strategy for the infrastructure development of Bangladesh.

7.5 Government, financial institutions and Non Government Organizations (NGOs) may take necessary steps to ensure uninterrupted financial support to the prospective SMEs in Bangladesh.

7.6 Due to the absence of uniform definition the policy formulation and implementations are not possible. Government should take initiative to develop a uniform definition of each category of SMEs.

7.7 Govt. of Bangladesh should take the initiative to develop web pages exclusively for SME and an integrated SME database. It will reduce the barriers to SME access to global market.

7.8 In order to ensure the retention of skilled workforce the government should make the entrepreneurial career attractive by minimizing the uncertainty.

7.9 In order to encourage women entrepreneurship govt. may;
involve women entrepreneurs in policy formulation and implementation.
arrange funds for women entrepreneurs.

provide necessary training to women entrepreneurs in rural and urban area of Bangladesh.

7.10 SME foundation may take appropriate marketing tools to popularize their products.

7.11 For minimizing red tapes and accelerating the growth of SME government may provide one roof service under the SME foundation.

7.12 Appropriate legal framework is necessary to ensure the development of SME of Bangladesh.

7.13 In this era of intense competition continuous planning and quality improvement act as a prerequisite for the survival of SMEs. In order to improve the quality SMEs can follow the Just in Time (JIT) philosophy and use Total Quality Management (TQM) and can ensure the improvement of quality and productivity at a time.

7.14 Government should establish a credible certification authority especially for SMEs. So that this sector can obtain a technical evaluation of the quality of their products within a shortest possible time. The certification of the authority should be world wide accepted. Govt. may also provide assistance to SMEs during the certification process and promote the importance of product certification for international acceptance among the SMEs.

7.15 Research and Development (R&D) is must for the development and growth of SME. So government must have to invest in R&D for ensuring the intensification of SME of Bangladesh.

7.16 Restriction may be imposed on import of SMEs' products which are available in Bangladesh.

8. Conclusion

Small and medium enterprises (SMEs) act as a vital player for the economic growth, poverty alleviation and rapid industrialization of the developing countries like Bangladesh. SMEs are significant in underlying country's economic growth, employment generation and accelerated industrialization. Government of Bangladesh has highlighted the importance of SME in the Industrial Policy-2005. SME has identified by the Ministry of Industries as a 'thrust sector'. As the SME sector is labor intensive, it can create more employment opportunities. For this reason government of Bangladesh has recognized SME as a poverty alleviation tool. SME also foster the development of entrepreneurial skills and innovation. Along with poverty alleviation SME can reduce the urban migration and increased cash flow in rural areas. As a result it will enhance the standard of living in rural areas.

Performance of SMEs in Bangladesh is significantly found below the level of international standard. Although government of Bangladesh has taken some initiative to ensure the growth of SME but those steps are not enough at all. But government shows its positive attitude towards this sector. Bangladesh government should continue to give more focuses on some areas, such as arrangement of finance, provide infrastructure facilities, frame appropriate legal framework, establish national quality policy etc.

From the sequence of our analysis it seems that for the economic development of Bangladesh SME can play a vital role. We are quite optimistic that if the above mentioned suggestions are implemented then the growth of SME sector in Bangladesh will be accelerated.

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Table 1. Contribution of SMEs in the GDP on Bangladesh

Numbers of workers	Total Contribution to GDP (Taka)	Percentage of Total contribution
0-1	193 996 555 714	26
2-5	379 663 897 358	51
6-10	73 120 983 681	10
11-20	45 183 240 157	6
21-50	33 960 498 076	5
51-100	15 138 922 373	2
Total	741 064 097 360	100

Source: ICG/MIDAS Survey, 2003

Note: US \$ 1 = BDT 69.00

Table 2. Sector wise contribution of SME in GDP of Bangladesh (Taka)

	Total Contribution to GDP (Taka)	Percentage of Total Contribution
Agriculture	177 729 637 637	24
Fishing	32 872 674 464	4
Manufacturing	282 344 700 575	38
Construction	7 196 460 200	1
Wholesale and Retail trade and Repairs	171 335 861 390	23
Hotels and Restaurants	28 599 263 975	3
Transport, Storage and Communication	8 950 171 356	1
Real state, Renting and Business activities	13 771 436 794	2
Education	151 808 506	1
Health and Social Work	2 743 049 893	1
Other Service activities	15 632 094 785	2
Total	741 327 159 609	100

Source: ICG/MIDAS Survey, 2004

Note: US \$ 1 = BDT 69.00

Table 3. Growth Pattern of SME

Year	Growth Percentage of Small Enterprises
2001-02	7.69
2002-03	7.21
2003-04	7.45
2004-05	7.93
2005-06	9.21
2006-07	10.28

Source: Bangladesh Economic Review 2006-2007

Table 4. Growth Pattern of Manufacturing Sector

Year	Growth Percentage of Manufacturing Sector
1972-2005	6.4
2001-02	5.48
2002-03	6.75
2003-04	7.10
2004-05	8.19
2005-06	10.77
2006-07	11.19
2015	Expected Growth 15

Source: Bangladesh Economic Review 2006-2007