

# **SME Financing Practices in Bangladesh: Scenario and Challenges Evaluation**

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*The main aim of the study is to evaluate the SME financing scenario and challenges in Bangladesh. At first, researcher want to see the importance of SME in Bangladesh , which sectors get SME financing, which institutions provides the SME financing then analysis the present scenario of SME financing . And, finally this provides key challenges. This study uses Bangladesh Bank data for FY 2011-15,Ministry of Finance, GOB, 2003-2012,Export Promotion Bureau (EPB) and BAPA 2006-2011.The findings of the study suggests that the success rate of SME financing is very high as well as it contributes to the GDP significantly in Bangladesh but disbursement of SME loan is low than industrials loan.*

**Keywords:** SME, BB, Micro, Challenges, Financing.

## **1. Introduction**

This study mainly focuses on present SME financing scenario and challenges in Bangladesh. It also explains reasons for SME considered as driving force for industrialization as well as to solve SME challenges. This study is greatly importance to the field of socio-economy and especially financial institutions because on the basis of this report they make the decision. The greater degree of loan disbursement to the SME sectors it indicates that the success rate is very high to SME sectors and vice versa.

This study is different from others because it objectives, analysis and findings is different. The first section of this study discusses literature review. The second section of this study discusses methodology of study. The third section of this study discusses findings and analysis. The last section of this study discusses conclusion and references.

## **2. Literature Review**

At present the most important issue of development of a country is SME .So that around the world many researcher and policy makers concern for that. Now we present some of the notable ones are; Uddin (2008), Chowdhury (2007), Miah (2007), Ahmed (2006), MIDAS (2004), ICG (2003), Hallberg (2002).

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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.

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:

### **Sources of funds Percentage of finance**

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. Sulaiman (2005) observed that the 50.53 percent of SMEs had no access to formal source of finance. Only 35.79 percent of SMEs enjoy unrestricted access to the formal credit. Of the rest 13.68 percent have restricted access to formal credit. Bank credit is used by small percentage of entrepreneurs and provides financing of generally less than 20 percent of their total outlay. Majority of the SMEs (59.6 percent) seek finance for their working capital needs from banks, although only a half-of them get loan from banks.

The research works as abovementioned has focused on different issues like performance of SMEs depend on efficiency of macroeconomic policy, Bangladeshi SMEs is characterized by low amount

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of capital, poor financial knowledge, high borrowing cost, major constraints of SME insufficient of funds, informal sectors provide 41%, NGO 17%, Bank only 18%, most important ingredients of SME success is stable macro economy. On the basis of above works it is clearly that there is mostly absent of SME financing scenario analysis and challenges evaluation. On basis of present scenario stakeholders make the decision. That's why researcher interested to explore the gray area.

### 3. Methodology

The analysis of the study was conducted by using secondary data like Bangladesh Bank quarterly SME statement, Bangladesh Bank (BB) Small and Medium Enterprise (SME) Credit Policies & Programmes, MIDAS, SME foundation, BBS, newspaper, research reports, journals, books, media etc.

### 4. Findings of the Study

This study tends to present the overall findings with some sub heads to differentiate various aspects regarding the subject matter. The explanation thus goes as the following:

#### 4.1 Definition of SME

SME-means Small & Medium Enterprise (SME). The definition of SME is differs from country to country. **The industrial policy of Bangladesh, 2010** defines Small &Medium Enterprise as : “In manufacturing ,small industry will be deemed to comprise enterprises with either the value (replacement cost) of fixed assets excluding land & building between Tk.5 million & Tk.100 million, or with between 25 & 99 workers,” and “medium industry will be deemed to comprise enterprises with either the value (replacement cost) of fixed assets excluding land & building between Tk.100 million & Tk.300 million, or with between 100& 250workers”.

According to the Pakistan SME policy, 2007, “enterprises which employ up to 250 workers or a paid up capital of Rs.25 million or lower are categorized as SME”:

The govt. of India enacted the Micro, Small & Medium Enterprises Development (MSMED) Act, 2006, and according to that act, “A small enterprise is an enterprise where the investment in plant & machinery is more than Rs. 25 Lacks but not exceed Rs.5 crore; and a medium enterprise is an enterprise where the investment in plant and machinery is more than Rs. 5 crore but not exceed Rs. 10 crore”.

Bangladesh Bank identifies the criteria of the definition of SME are given below:

S=Small Enterprise.

Small Enterprise means to the business which is not public ltd company & fulfills the following criteria:

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**Table 1: Definition of Small Enterprise**

S.L.	Sector	Fixed asset other than land & building (Tk.)	Employed Manpower(not above)
1	Service	50000-5000000	25
2	Business	50000-5000000	25
3	Industrial	50000-15000000	50

Source: Bangladesh Bank (BB) Small and Medium Enterprise (SME) Credit Policies & Programmes.pp.7.

M= Medium Enterprise.

Medium Enterprise means to the establishment /firms which is not public ltd company & complies the following criteria:

**Table 2: Definition of Medium Enterprise**

S.L.	Sector	Fixed asset other than land & building (Tk.)	Employed Manpower(not above)
1	Service	5000000-100000000	50
2	Business	5000000-100000000	50
3	Industrial	15000000-200000000	150

Source: Bangladesh Bank (BB) Small and Medium Enterprise (SME) Credit Policies & Programmes.pp.7.

## 4.2 Importance of SME in Bangladesh

Today SME is considered a “driving force for Industrialization”. In whole Bangladesh SME sectors are growing well. As a result Govt. of Bangladesh is very much concern about that and Bangladesh Bank, commercial bank, financial institutions more emphasis on this issue. So, SME is very important in Bangladesh for following reasons:

- SME remains the engine of economic growth and considering the population of Bangladesh.
- SME offers large scale employment and income generating opportunities at relatively low cost.
- It strengthens efforts to achieve high and sustainable growth, which is a prerequisite for an exit from widespread poverty and socio- economic deficit.
- SME enhances women empowerment. Because in SME, women entrepreneurship plays a pivotal role.
- Rural areas sectors are entering to the main stream.
- SME requires low amount of investment.

## 4.3 Sectors for SME Financing

Bangladesh Bank identifies the following sectors that only get SME loan. The most common sectors are given below:

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**Table 3: Sectors of SME Financing**

Sl. No.	Sector Name	Sl. No.	Sector Name
01	Agro-based and agro-processing industry;	39	Electronics
02	Agro-based activities such as fishing, fish preservation and marketing;	40	Artificial flower making;
03	Agro-tools making and marketing;	41	Optical frame manufacturing;
04	Fishing boat building;	42	Silkworm and silk industry;
05	NakshiKhata and handloom;	43	Stuffed toys;
06	Food seed preservation and marketing;	44	Ice mill;
07	Bakery;	45	Iodized salt production;
08	Hatchery;	46	Rice mill/Auto rice mill
09	Dry fish processing;	47	Wholesale and retail shop;
10	IT-based activities;	48	Drug house/Pharmacy
11	Computer software and ICT goods;	49	Phone-Fax
12	Cyber cafe;	50	Local transport
13	Horticulture, floriculture & flower marketing;	51	Chatal business
14	Cold storage;	52	Old Iron goods
15	Hospital and clinic;	53	Mobile set and accessories
16	Hotel, restaurant and tourism;	54	Electronics business;
17	Telecommunication;	55	Agro machinery/tools business
18	Mobile phone accessories,	56	Fertilizer business;
19	Printing and packaging;	57	Jute trading;
20	Light engineering industry;	58	Clothing and shoe business;
21	Plastic industry;	59	Rod and cement trading;
22	Cosmetics and toiletries;	60	Hardware business;
23	Handicrafts;	61	Crockery business
24	Herbal medicine industry;	62	Grocery and chaff goods business
25	Jute goods and jute mixed goods;	63	LP gas businesses;
26	Stationery goods industry;	64	Warehouse and container service;
27	Frozen food;	65	Commercial plantation;
28	Leather and leather products;	66	Photography;
29	Transport and communication;	67	Oil and pulse mill;
30	Laboratory;	68	Manufacturing of cement pillar
31	Jewellery;	69	Mini sugar mill;
32	Ginning and baling;	70	Molasses production;
33	Tailoring;	71	Hosiery;
34	Saloon and beauty parlour, gymnasium;	72	Welding industry;
35	Community centre;	73	Partex industry
36	Diagnostic centre;	74	Biogas plant;
37	Digital color lab;	75	Sweetmeat production;
38	Cable operators;	76	Fish cultivation (shrimp, telapia, pangas)

Source: Bangladesh Bank (BB) Small and Medium Enterprise (SME) Credit Policies & Programmes

### 4.4 Scenario of SME Financing in Bangladesh:

Bangladesh Bank has strong directive for opening branches, separate provision for loans & many other positive policies but in reality, financing system for SMEs has not been improved up to the desired level.

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Now, for our analysis purpose we classify the following three broad fragmented sectors available for financing SMEs:

- a) Formal sectors
- b) Semi-formal sectors
- c) Informal sectors

### a) Formal sectors:

The formal sectors include all regulated institutions like banks, non-bank financial institutions, insurance company, capital market intermediaries, micro finance institutions etc.

Now, we analyze the formal sectors that provide SME loan.

**Table 4: List of Bangladeshi Commercial Banks**

<ul style="list-style-type: none"> <li>➤ AB Bank Limited</li> <li>➤ Bangladesh Commerce Bank Limited</li> <li>➤ Bangladesh Development Bank Limited</li> <li>➤ Bank Asia Limited</li> <li>➤ Brac Bank Limited</li> <li>➤ Commercial Bank of Ceylon</li> <li>➤ Dhaka Bank Limited</li> </ul>	<ul style="list-style-type: none"> <li>➤ NRB Bank Limited</li> <li>➤ NRB Commercial Bank Limited</li> <li>➤ One Bank Limited</li> <li>➤ Prime Bank Limited</li> <li>➤ Pubali Bank Limited</li> <li>➤ Rupali Bank Limited</li> </ul>
<ul style="list-style-type: none"> <li>Eastern Bank Limited</li> <li>IFIC Bank Limited</li> <li>Jamuna Bank Limited</li> <li>Janata Bank Limited</li> <li>Meghna Bank Limited</li> <li>Midland Bank Limited</li> <li>Mutual Trust Bank Limited</li> <li>National Bank Limited</li> <li>NCC Bank Limited</li> </ul>	<ul style="list-style-type: none"> <li>South Bangla Agri. &amp; Com. Bank Limited</li> <li>Southeast Bank Limited</li> <li>Standard Bank Limited</li> <li>The City Bank Limited</li> <li>The Farmers Bank Limited</li> <li>The Premier Bank Limited</li> <li>The Trust Bank Limited</li> </ul>

Source: Bangladesh Bank (BB) Small and Medium Enterprise (SME) Credit Policies & Programs.

### Analysis:

There are 56 commercial banks in Bangladesh. But only 29 commercial banks provide SME loan that are not satisfactory level for SME financing.

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**Table 5: List of Financial Institutions**

<ul style="list-style-type: none"> <li>➤ Bangladesh Industrial Finance Co. Limited</li> <li>➤ Bangladesh Finance and Investment Company Limited</li> <li>➤ Bay Leasing and Investment Limited</li> <li>➤ Fareast Finance and Investment Limited</li> <li>➤ FAS Finance Limited</li> <li>➤ First Lease Finance and Investment Limited</li> <li>➤ IDLC Finance Limited</li> <li>➤ IIDFC Limited</li> <li>➤ Islamic Finance and Investment Limited</li> <li>➤ Lanka Bangla Finance Limited</li> </ul>	<ul style="list-style-type: none"> <li>➤ Midas Financing Limited</li> <li>➤ National Housing Finance &amp; Investments Limited</li> <li>➤ People's Leasing &amp; Financial Services Limited</li> <li>➤ Pheonix Finance and Investment Limited</li> <li>➤ Prime Finance and Investment Limited</li> <li>➤ Reliance Finance Limited</li> <li>➤ Union Capital Limited</li> <li>➤ United Leasing Company Limited</li> <li>➤ Uttara Finance and Investment Limited</li> </ul>
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Source: Bangladesh Bank (BB) Small and Medium Enterprise (SME) Credit Policies & Programs.

Some statistics below can give us share of SME loans provided by the banks:

**Table 6: Industrial Term Loan  
(Taka in crore)**

Period	Disbursement				Recovery			
	LSI	MSI	SSCI	Total	LSI	MSI	SSCI	Total
<b>FY 2011-12</b>	21918 62.13%	10969 31.09%	2392 6.78%	35279	17979 82.03%	9916 90.40%	2342 97.91%	30237
<b>FY 2012-13</b>	27955 65.73%	11574 27.65%	2999 7.05%	42528	24288 86.88%	9468 81.80%	2794 93.16%	36550
<b>Jan-March 2014</b>	6054 65.21%	2331 25.11%	899 9.68%	9284	6976 115.23%	2087 89.53%	747 83.09%	9810
<b>April-June 2014</b>	7650 66.74%	2848 40.55%	965 8.42%	11463	7023 91.80%	2359 82.83%	797 82.59%	10179

Source: Bangladesh Bank

### **Analysis:**

Loan disbursement in the Large Scale Industries(LSI) is 62.13% of the total, Medium Scale Industries(MSI) and Small Scale and Cottage Industries(SSCI) together received 37.87%, about two thirds of the total banking finance goes to the LSI. In the year 2012-13, the situation rather deteriorated in favor of SMEs, share of LSI improved and reached to about 66%, remaining 34.65goes to the MSI and SSCI.

In case of overdue and outstanding, the scenario is opposite:

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**Table 7: Overdue and outstanding loan  
(Taka in crore)**

	Overdue				Outstanding			
	LSI	MSI	SSCI	Total	LSI	MSI	SSCI	Total
<b>End of June 2014</b>	5936	3965	1006	10907	69621 69.35%	24695 24.60%	6079 6.06%	100395

Source: Bangladesh Bank

### **Analysis:**

Outstanding for LSI is the highest about 70%, while in the SSCI it is the lowest to about 6.06%. There could be some details of the statistics to help understanding the actual situation if number of industries, sectors are mentioned along with the above statistics. Banks are willingly reluctant to provide loans to the SSCI sectors even though their single requirements are much less than the LSI, in order to avoid administrative costs and risks, Banks are reluctant to finance SMEs.

**Table 8: Quarterly SME loan Statement  
As on 31.03.2015  
(Tk. In Crore)**

Name of the Sector		Target of	Disbursement of the Current	New Enterprise Financing	Disbursement without Collateral	Rural Disbursement
Total of Financial Sector	CMSME	<b>104586.49</b>	<b>26139.28</b>	<b>4687.3</b>	<b>3411.01</b>	<b>5881.05</b>
	Cottage	<b>5681.20</b>	<b>460.92</b>	<b>65.10</b>	<b>209.27</b>	<b>274.54</b>
	Micro	<b>12073.8</b>	<b>1926.02</b>	<b>312.52</b>	<b>317.03</b>	<b>1068.36</b>
	Small	<b>41931.42</b>	<b>10716.96</b>	<b>2381.57</b>	<b>1430.13</b>	<b>2205.07</b>
	Medium	<b>44900.07</b>	<b>13036.19</b>	<b>1928.11</b>	<b>1454.58</b>	<b>1940.05</b>
	Woman	<b>6509.09</b>	<b>886.72</b>	<b>143.07</b>	<b>310.8</b>	<b>86.92</b>

Source: Bangladesh Bank, SME financing reporting(31.3.2015)

**Analysis:** So, we see that CMSME sector is the highest of target, disbursement, new enterprise financing, and disbursement without collateral & rural disbursement than other sector as on March 31, 2015.



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**Table 9: Contribution of Large and Small Industries to the GDP (%) at constant price base year 1995-96**

	FY03	FY04	FY05	FY06	FY07	FY08	FY09	FY10	FY11	FY12
<b>Large and medium scale</b>	11.29	11.47	12.14	12.1	12.5	12.6	12.7	12.7	13.2	13.8
<b>Small scale</b>	4.68	4.78	4.94	4.9	5.1	5.1	5.2	5.3	5.2	5.3
	<b>15.97</b>	<b>16.25</b>	<b>17.08</b>	<b>17</b>	<b>17.6</b>	<b>17.7</b>	<b>17.9</b>	<b>18</b>	<b>18.4</b>	<b>19.1</b>

Source: Economic Review, Ministry of Finance, GOB, 2003-2012

**Analysis:** It is clear that SME sector significantly contributes to GDP and rate is improving over time. In FY03 SMEs contribution was 15.97% which increased to 19.1% in 9 years. It is also obvious that the major contribution comes from larger and medium scale industries contributing about 13.8% in fiscal year 2011-12.

### SMEs Contribution in Employment Generation

Despite higher economic growth, employment grew at a relatively slow rate of 1.6 percent per annum since the 1990s. At the aggregate level, agriculture is still the largest sector of employment providing jobs to 22.8 million compared with 6.9 million in industry and 17.7 million in the services sector in 2006. While the overall contribution of SMEs to the national economy is easily recognized, opinions differ on the extent of the contribution of this sector in employment generation. Various categories of SMEs together provide 80 to 85 per cent of industrial employment and 25 per cent of total civilian employment. There are also significant contributors to backward linkage to heavy industries.

**Table 10: Export Earnings Growth in SME**

<b>Financial Year (FY)</b>	<b>Million US\$</b>	<b>Growth over the previous year</b>
<b>2006-2007</b>	<b>22.94</b>	<b>118.68 %</b>
<b>2007-2008</b>	<b>40.65</b>	<b>77.20 %</b>
<b>2008-2009</b>	<b>46.68</b>	<b>14.83 %</b>
<b>2009-2010</b>	<b>53.68</b>	<b>14.99 %</b>
<b>2010-2011</b>	<b>56.00</b>	<b>4.32 %</b>

Source: Export Promotion Bureau (EPB) and BAPA

**Analysis:** It evident that in the early years of this newly growing sector i.e. before 2000, the export of agro processed food products was limited and the earning was not significant. In 2001-02 it was

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nearly US\$ 21.56 million which grew to US\$ 56.00 million in 2010-11, quite encouraging in view of the present cloudy world economic recession.

### **b) Semi- Formal Sectors**

The semi formal sector includes those institutions which are regulated otherwise but don't fall under the jurisdiction of Central Bank, some of these are; Insurance Authority, Securities and Exchange Commission or any other enacted financial regulator. This sectors mainly represented by Specialized Financial Institutions like House Building Finance Corporation(HBFC), Palli Karma Sahayak Foundation (PKSF), Samabay Bank, Grameen Bank etc., Non Governmental Organizations (NGOs) and discrete government programs.

### **c) Informal Sectors**

The informal sector includes private intermediaries which are completely unregulated and unregistered in most of the cases.

## **4.5 Challenges of SME Financing in Bangladesh:**

SME in Bangladesh is a significant sector for economic and social development that already we seen it. Now we want to see this crucial sector is facing following types of challenges:

### **i. Lack of access to finance:**

Institutional limitations, such as an underdeveloped and inefficient legal and regulatory framework pose significant barriers to effective financing. Banks face a number of issues in lending to SMEs, the most pronounced being information asymmetry and granularity, the level of detail available on which to base business decisions. Banks do not have the requisite information and systems in place to quantify risk and differentiate between SMEs. This has resulted in tightened credit terms and in the inefficient allocation of resources. Another factor is the issue of moral hazard, wherein SMEs are perceived to take higher risks than larger companies with funds borrowed from banks. Therefore government should work toward implementing a mechanism under which SMEs are mandated to provide accurate, reliable, and quality information to banks so that lenders can carry out precise risk assessments.

### **ii. High cost of finance:**

The high cost of finance is a common problem for SMEs. The underlying perception is that loan repayments are not borrower-friendly. This can primarily be attributed to both a mismatch in terms of repayment cycles i.e. the cash flow cycles of different businesses (which will not be the same in the examples of poultry producers, cold storage companies, crop farmers, packing unit and foundries) and in a lack of flexibility in repayment terms.

### **iii. Large collateral requirements:**

Banks are also known to demand large amounts of collateral from SMEs because lending systems are based more on borrowing backed by assets than project earnings and cash flow. Many banks have revealed that they insist on large collateral as a safeguard to losses from risk exposure. Collateral-based lending can prove a major barrier because of the difficulties faced in assessing the quality of land offered and in obtaining an unblemished ownership title and deed. On many occasions, banks also do not accept the same kind of collateral from SMEs (such as sales or

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project contracts) that they would from large borrowers. Another problem with SME lending is the mismatch between the loan size and the value of collateral as, in most cases; the value of the collateral is typically greater than the loan sought.

### **iv. Credit information gap:**

The absence or limited track record of Credit Rating Agency (CRA), with regard to SME ratings, low analyst coverage of SMEs, and lack of access to information are some of the key barriers to credit appraisals of SMEs. The ability of banks to develop exhaustive credit models for the SME segment is impaired by lack of data.

### **v. Cumbersome documentation process:**

Borrowers face difficulties in comprehending documentation processes stipulated by lenders, many of which have been found to be exhaustive and too complex.

### **vi. Limited spread and reaches of banks:**

The limited network of banks in smaller towns and rural areas restricts borrowers' access to credit. Although the banking sector is the most important source of external financing for SMEs, they under serve the needs of the sector, since many SMEs are forced to rely on retained earnings and informal avenues for borrowing that can take considerable time to accumulate. Shortage of finance could well be the primary impairment to the competitiveness and growth of SMEs in Bangladesh.

### **vii. Borrowers are less Skilled:**

Most of the borrowers are less skilled. They don't properly use their loan money. Several studies shows that most of rural areas borrower utilized their money unproductive sector.

### **viii. Insufficient Training Academy:**

Training centers are limited& those are presenting not effective for the borrowers.

### **ix. Lack of Women Participation:**

The half of total population in Bangladesh is women. But in reality there are no representing figures in women entrepreneurship.

## **5. Conclusion**

SME is crucial sector for Bangladesh. Bangladesh Bank has Small and Medium Enterprise (SME) Credit Policies & Programs. That identified lots sectors for SME financing. This study point out that bank and financial institutions does not concentrate on SME loan rather they concentrate on industrial loan. The recovery rate is very high for SME loan and economic contribution is also high. But this sector faces lots of challenges like high rate of interest, much complexity, and lack of formal sectors. By using this research stakeholders easily understand at present scenario and challenges of SME financing in Bangladesh.

## **6. Limitations of the Study**

The research work focused basically the SME sectors and the importance of these sectors. The study evaluated present scenario and challenges of SME sector in Bangladesh. This study doesn't

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use any hypothesis and model for analyzing the present scenario and challenges. This study doesn't any recommendations for mitigating challenge.

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