

**Policy Strategies for Small & Medium Enterprises (SME) Development in
Bangladesh**

January 2005

Ministry of Industries
Government of the People's Republic of Bangladesh

01. INTRODUCTION

01.1. Small and Medium Enterprises (SMEs) have historically been one staple of the enterprise landscape within economies globally. Especially growth with clear benefits for poverty reduction puts a premium on integrating, productively and profitably, small and medium enterprises in the very process of economic growth. The over-riding vision must be for setting up a market-based economic order with a level playing field for all enterprises, in which SMEs can aspire to opportunities of growth and wealth-creation commensurate with their own endowments and diligence, innovation and management commitment. In addition, the vision must lead to a priority in the delivery of government services so as to neutralize, on a continuing basis, the

handicaps and irritants which, almost reflexively, tend to spring themselves upon SMEs in a selective manner. A historically accelerated pace of trade liberalization in Bangladesh since the early 1990s by spurring a veritable deluge of imports has quite significantly increased competitive pressures on SMEs in Bangladesh. Rapidly falling cost of communications have by unifying global markets heightened the intensity of competition. Trading is widely seen as a safer, richer, smarter and bulkier career to have than manufacturing--bad news indeed for industrialization. With this end in view, Government of Bangladesh formulated the National Industrial Policy 2005 by giving special emphasize for developing Small and Medium Enterprises (SMEs) as a thrust sector for balanced and sustainable industrial development in the country with the vision for facing the challenges of free market economy and globalization.

01.2. Implementation of poverty alleviation action programs and strategies is a systematic and continuous attempt in Bangladesh. For the purpose, the Poverty Reduction Strategy Paper (PRSP) of 2004 has been clearly identified some core principles and parameters both at macro and micro levels for reducing the existing poverty levels at least half fold within 2015 as targeted by the Millennium Development Goal (MDGS).

In the policy strategies, smooth and sustainable development of SMEs all over the country will be considered as one of the vehicles for accelerating national economic growth including poverty alleviation, reduction of unemployment, and generation of more employment. Most of the industrial enterprises in Bangladesh are typically SME in nature. Generally SMEs are labor intensive with relatively low capital intensity. The SME also posses a character of privilege as cost effective and comparative cost advantages in nature. In this consonant, the SME policy strategies have been formulated in line with the acknowledged principles for achieving the Millennium Development Goals (MDGs) by the Government.

02. POLICY OF THE GOVERNMENT:

The Government is committed to develop SME's as the vehicles for quality of life improvement, economic growth and poverty alleviation of the common people. The primary role of the Government shall be that of a facilitator to aid naturally growing SME's through removing market and policy obstacles, and secondly providing necessary promotional support.

03. OBJECTIVES OF THE POLICY STRATEGIES

The broad objectives of the policy strategies shall be to:

- 1) Accept SMEs as an indispensable player in growth acceleration and poverty reduction, worthy of its total commitment in the requisite overall policy formulation and execution;
- 2) The SME policy strategies shall essentially be linked with broad-based and integrated manner in line with the poverty reduction strategy paper of the Government of Bangladesh.
- 3) Encourage and induce private sector development and promote the growth of FDI, develop a code of ethics and establish good governance, ICT based knowledge management and customer supremacy in the market alliances.
- 4) Identify and establish the network of infrastructure and institutional delivery mechanisms that facilitate the promotion of SMEs;
- 5) Re-orient the existing fiscal and regulatory framework and government support institutions towards bolstering the goals of SME policy;
- 6) Nurture and partner civil-society institution(s) having credible management teams in terms of the delivery of needed services, leadership, initiation, counseling, mentoring and tutoring; etc.
- 7) Create innovative but meritocratic arrangements so that deserving and especially small enterprises with desired entrepreneurial antecedents and promise can be offered financial incentives within industries prescribed on some well-agreed bases.
- 8) Help implement dispute settlement procedures that proactively shield small enterprises especially from high legal costs and insidious harassment.
- 9) Take measures to create avenues of mobilizing debt without collaterals to match (either using *debt-guarantee schemes* or mapping *intellectual-property* capital into *pseudo-venture capital*) in order to assist small enterprises in dealing with their pervasive lack of access to finance.
- 10) Accord, systematically, precedence to small *versus* medium enterprises, within the limitations of government's resources.

- 11) Harness information & communications technologies, Internet Protocol (IP)-based infrastructure, and electronic-governance in an effort to parlay regulatory services, all kinds of useful information and mentoring inputs, with an accent on increasing the viability of SMEs in all sectors of the economy.

04. NATIONAL TASKFORCE ON SME DEVELOPMENT

The Government has constituted a National Taskforce on SME Development to draw up a realistic strategy for promoting rapid growth and vigorous competitiveness among SMEs in Bangladesh in the interest of accelerating the growth of the economy and reduction of poverty in the country. The composition of the National Taskforce is provided in Annexure-1. The Taskforce has submitted its report with comprehensive recommendations for formulation of SME policy strategies and its implementation in three phases: short, medium and long-term. The government has accepted the recommendations.

05. SME ADVISORY PANEL:

An SME Advisory Panel shall be constituted involving experienced committed specialists and entrepreneurs of relevance to work together with the SME cell of the Ministry of Industries (MOI). In the medium term the Advisory Panel and the SME Cell will eventually morph into SME Foundation. The composition of the Advisory Panel is provided in Annexure-2.

06. SME FOUNDATION:

- Over the medium term and beyond, the Government shall form an SME Foundation as a pivotal platform for the delivery of all planning, developmental, financing, awareness-raising, evaluation and advocacy services in the name of all SME development as a crucially-important element of poverty alleviation.
- The Foundation would strive to provision one-window delivery of all administrative facilities, including some resources needed for capacity-building in appropriate industry association(s), for SMEs in Bangladesh.

07. DEFINITIONS:

Enterprises shall be categorized using the following definition (fixed investment implies exclusion of land and building, and valuation on the basis of current replacement cost only):

- ◆ **Small enterprise:** an enterprise should be treated as *small* if, in today's 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 be up to Tk. 15 million;
- ◆ **Medium enterprise:** an enterprise would be treated as *medium* if, in today's market prices, the replacement cost of plant, machinery, and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and building, were to be up to Tk. 100 million;
- a. For **non-manufacturing** activities (such as trading or other services), the Taskforce defines:
 - ◆ **Small enterprise:** an enterprise should be treated as *small* if it has less than 25 workers, in full-time equivalents;
 - ◆ **Medium enterprise:** an enterprise would be treated as *medium* if it has between 25 and 100 employees;

08. BOOSTER SECTORS:

For promotional support the following 11 booster sectors has been identified and the list shall be reviewed every three years:

- I. Electronics and Electrical
- II. Software Development
- III. Light Engineering
- IV. Agro-processing and related business
- V. Leather and Leather goods

- VI. Knitwear and Ready Made Garments
- VII. Plastics and other synthetics
- VIII. Healthcare and Diagnostics
- IX. Educational Services
- X. Pharmaceuticals/ Cosmetics/ Toiletries
- XI. Fashion-rich personal effects, wear and consumption goods.

09. PREFERENTIAL CRITERIA:

Enterprises which as well as meeting the size requirement shall have

- a. proven credentials as an entrepreneur (for example, membership in well-recognized social occupational groupings, successful track record) with requisite presence and facilities on the ground;
- b. an above-average *insiders' equity participation*;
- c. certifiable professional specialization of top-management in relevant production skills;
- d. the stamp of approval from globally-recognized quality-assurance bodies (ISO 9001:2000, for example);
- e. High management commitment to innovation.
- f. Women entrepreneurs will be accorded preference, wherever appropriate.
- g. Other things being equal, smaller enterprises shall be given preference in terms of benefits from interventions by the government and civil society initiatives.
- h. A preferential criteria be set based on the size of an enterprise – smallest getting the top priority.
- i. Women entrepreneurs shall be given preference in conjunction with the above criteria.
- j.

10. TAX HOLIDAY AND OTHER INCENTIVES:

Small and medium enterprises will enjoy the tax holiday and other incentives as stated in the National Industrial Policy 2005.

11. CREDIT-DISTRIBUTION PACKAGE AND VENTURE CAPITAL- MARKET

- a. A credit-distribution package shall be worked out by the Ministry of Industries. An innovative scheme--rather like a two-stage screening mechanism---that can really probe for the bone fide of the applicants as entrepreneur material will be deployed.
- b. Donor financial resources made available specifically to help with implementation of SME policy being enunciated here would only be allocated to competitively-selected enterprises within the booster industries here being prescribed.
- c. Of the total resources available, no more than 20% may be earmarked for medium enterprises, while the remainder, 80%, will be earmarked for small enterprises. Within each division, the resources will be divided up into a public-sector venture-capital fund (10%), approximately on the lines of the currently-implemented EEF at the Bangladesh Bank. The remainder will be allocated to a *credit fund*. (This does not have anything to do with debt-equity ratio relevant in discussions of enterprise financing.)
- d. In the short run, the distribution of the credit fund and venture-capital fund will be the task of the BASIC Bank, which is here being recommended as the lead bank, it being borne in mind that BASIC Bank will closely work with the Advisory Panel. (Over the medium term, this responsibility will devolve to the SME Foundation.)
- e. The Ministry of Industry and the SME Advisory Panel/Foundation, as the case may be, will determine modalities of how to implement both the credit-fund and the venture-capital fund.
- f. Within the purview of the Advisory Panel, projects to be funded from the venture-capital fund will be evaluated by a team of experts which will be constituted as a part of the implementation of SME Policy.
- g. A publicly-mandated venture-capital scheme will be created in deference to the rationale cited in the main text. It will also give a stimulus to the morale of entrepreneurs who commit in-house capital to projects with novel and potentially innovative processes and technologies with demonstrable potential

for commercial success. Such projects have a-typically high risk and high returns. This recommendation is rationalized in terms of the private under-investment based on extensive, even potentially crippling, negative pecuniary externalities in certain among the booster industries prescribed here, with regard to the leaching of shareholder's value outward from the enterprise.

- h. The Advisory Panel working together with the Lead Bank in the short-term, and the SME Foundation in the medium- and long-term would implement a transparent and meritocratic arrangement for steering public equity and debt resources into a genuinely deserving selection of enterprises.
- i. The development of human resources in both the BASIC Bank and the SME Foundation with regard to effective targeting of resources made available under public equity funding would remain imperative.

12. QUALITY-ASSURANCE (QA) CERTIFICATION

- a. Bangladesh Standards and Testing Institute (BSTI) with its accountability to SMEs fundamentally enhanced through appropriate SME representation in its governance, and with appropriate representation from civil society institution(s), shall become the focal point for offering assistance with regards to securing quality-assurance (QA) certification from registrars of QA.
- b. Suitable SME-related industry association(s) shall be empowered to issue non-mandatory certification, albeit with high professional integrity, with regard to quality assurance. Such association(s) would be eligible to grants from Government towards the cost of setting up required testing laboratories and other facilities.
- c. Small, out-right co-financing grants will be available for registration with globally branded QA registrars (say with ISO 9001: 2001 or equivalent).
- d.

13. MULTI-STAGE SAMPLE SURVEY OF SMES

There is an urgent need for a major overhaul of the availability of reliable and current *data* about the characteristics of SMEs. The Ministry of Industries shall immediately take up the conception and implementation of a multi-stage sample survey of SMEs in the metros and the district headquarters. Ideally,

there should be a complete enumeration of all SMEs, the data from which should be of use in drawing up a survey methodology for a systematic stratified random sampling.

14. TACTICAL PLAN OF ACTION

- a. **Strategic skills upgrading:** The tactical plan is needed to move from gap analyses to skills upgrading based on the product(s) in the booster-sectors identified in this report, paying careful attention to the requirements of the production clusters in the inner cities (such as Dholai Khal, Mirpur, and the like).
- b. **Enabling environment:** An enabling environment in which both extant and aspiring entrepreneurs find within an easy reach most of what they direly need---information, counseling, mentoring, access to finance, technology and the means to market.
- c. **Supply chain for technopreneurship:** A serious effort shall be made for fostering a *supply chain* for *technopreneurship*. Bangladesh needs role models that can get intelligent and diligent people excited about creating value through successful entrepreneurship. The SME Panel/SME Cell and the SME Foundation conceive programs in popular media, and anchor(s) for them to match, modeled after some widely-accepted success stories.
- d. **SME Web Portal:** An online-community, availing of relevant information and communication technologies, of both extant and aspiring SME entrepreneurs, shall be hosted on a SME Web portal in the SME Cell/SME Foundation, for the divining of technology, product and market trends, for career-counseling to benefit science/technology graduates, for technopreneurial problem-solving session(s), for mentoring using *guru-disciple symbiosis*.
- e. **Towards a virtual SME front-office:** A Web-based virtual *front-office* providing all start-up assistance to SME entrepreneurs (application forms, FAQs, limited directory-assistance, success stories, horror stories, etc) and an *one-stop-service*, with all interactions between the user and the system stored on databases shall be established in the interest of providing institutional memory.
- f. **Exports-friendly content on the SME portal:** Information regarding standards of labor and output pertaining to overseas markets to benefit export-oriented SMEs shall be put in place on the Web portal.

- g. Electronic-governance with a human touch:** Such structures of electronic-governance shall be supplemented, at least for a time, by human touch, with adequate budget to match, to physically attend to the needs of small entrepreneurs who take recourse to them. This is based on the recognition that a totally hands-off delivery of all requisite services to SMEs is an ideal whose achievement was likely to only happen in stages.
- h. High-performance communications backbone:** A high-performance fiber-optics communications backbone shall be put in place *in six* of the country's largest metro-markets (namely, Dhaka, Chittagong, Rajshahi, Khulna, Sylhet and Barisal) so that the launch of some serious ICT-centric applications to benefit e-governance to the profit of SME development is not unduly handicapped by woefully inadequate bandwidth.
- i. International technology-exchange programs:** Technology-exchange programs between countries with similar stages of development, and with a similar maturity of the infrastructural development for SME shall be implemented in the interest of rapid technology transfer.

15. FORMULATION OF A PACKAGE OF CAPACITY-BUILDING AND TRAINING

- a. Specialized professional expertise:** Specialized professional expertise in carefully-chosen niches that the Panel of Advisors recommends has potential for a broad-based replication. Such training can be so packaged to such high standards that the recipients feel motivated to pay up *user charges*, however minimal.
- b. Re-skilling boot camps:** Re-skilling *boot camps* would need to be organized for each of the booster industries by rotation, with a view to provide periodic technology grounding in efficacious skills among workers in SMEs.
- c. Institutional capacity for training:** BSCIC/SCITI, BIM, and BITAC---where a lot of equipment, infrastructure and other resources are in place---should undergo a significant strategic *reorientation of their own core competencies* under the watchful eye of the Advisory Panel/SME Cell. In particular, the skills and competencies needed to enable SME hold their own in the booster-industries in the changed global business environment should be re-emphasized in the ensuing revamping of these institutions.

- d. **Capacity for coordination among multiple institutions:** Several public institutions (such as Atomic Energy Commission (AEC), Bangladesh Council of Scientific Investigation & Research (BCSIR), Leather Training Institute (LTI), the Textile colleges, the Ceramics Research Institute, the public universities, etc) have significant capacity for both product- and process-innovation of real value for SME development. The case for harnessing all that productive capacity in a coherent and harmonious manner can be over-emphasized. However, achieving this will require a great deal of institutional coordination among various Ministries of the government.
- e. **Technical assistance and investment:** Towards this end (as stated above), technical assistance and investment are both urgently needed to appropriately accent the training and motivational in these institutions so that they can become durable fixtures of technical and managerial skills can be nurtured, in a format of public-private partnership.
- f. **Private-public collaboration:** The selection of such training courses and then the delivery of such training is an important instance of *public-private collaboration*.
- g. **R & D with potentially high-impact profiles:** R & D that lead to prototypes with a scope for replication in potentially high-impact product *niches* (eg in the field of mobile games, 3-D animation, or bio-optics, or the manufacture of computer-controlled industrial and medical appliances, or spurring the use of resin in new production applications, etc);
- h. **Curriculum development for vocational training:** Curriculum of vocational training institutes be revised and reviewed to make it SME development friendly.

16. EVOLVING OF AN SME ECO-SYSTEM

Two kinds of institutions are recommended, preferably for adoption by civil society role models/ catalysts, bearing in mind that these institutions will not be in the employ of the government.

- a. The mission of the first kind is in trying to render stakeholders out of indigenous young science and technology graduates by bringing to their agenda for poverty alleviation the currently-missing *fulcrum* of technological innovations to improve the quality of life of the poor in Bangladesh.

- b. The mission of the second is to achieve mastery over a rapidly-changing slate of IT skills, and to then quickly disseminate them among young self-starters, including in the university/polytechnic/colleges' stream, through a regime of online and "brick-and-mortar" interactions.
- c. Efforts to accelerate the retention and promotion of women entrepreneurs should be strengthened.
- d. Greater stakeholder involvement in the entire gamut of activities by way of SME development while maximizing the extent of ownership to be promoted.

17. MITIGATING IMPEDIMENTS IN CLUSTERS

There shall be an effort to identify three or four promising *lines of production* in a handful of clusters in the metros of Dhaka and Chittagong, where small enterprises abound. Gap analyses that lead to the diagnoses of weaknesses that stymie their productivity shall be launched. Several *technical assistance studies* shall then be aimed at these problems.

18. EDUCATION AND GENERATIONAL ETHOS

- a. Bangladesh should increase the number, and enhance the quality of technical education in, the country's *polytechnic institutes* in the interest of increasing the number of entrepreneurs.
- b. Content of a kind that seed, early on in the global-view of the children, the attractiveness of entrepreneurial careers should be pressed into service.
- c. Similarly, the accent on mathematics, science and technology fare should be made stronger in the educational curricula of schools and colleges in Bangladesh.
- d. A census of all small and medium enterprises in Bangladesh should be conducted. This is likely to require a very large investment.
- e. The legal and contractual framework prevailing in Bangladesh often increases especially small enterprises' handicaps. A survey of SMEs should be launched in order to identify these insidious legal irritants. These should then be systematically weaned from the world of Bangladeshi SMEs.
- f. A small-claims court needs to be instituted, with requisite resources and mandate to match.

Chapter I

INTRODUCTION

1.0 Importance of SMEs

1.1 Small and Medium Enterprises (SMEs) are the dominant form of business organization in all countries, typically accounting for over 95% of the business population. OECD recognized that SMEs constitute an important dynamic element in all economies as they drive innovation, especially in knowledge-based industries; and play a key role in driving sustainable economic growth, employment creation and poverty reduction, especially in developing countries. It also contributes to the social, cultural and environmental capital of nations.

1.2 In view of the rapid structural change in the world economy, especially in favor of increasingly weightless, paperless, knowledge-rich *industries and services*, to see structural change and remaining relevant as major imperatives for intervention by government and the civil society.

1.3 Acknowledging the importance of SMEs and entrepreneurship, the Government of Bangladesh reaffirming their commitment takes initiative to design a SME policies and strategies for its coherent growth. The Government of Bangladesh has constituted a National Taskforce on SME Development as Dr. Kamal Uddin Siddiqui, Principal Secretary to the Prime Minister as its chairman on 2003. (Annexure-1).

2.0 Terms of Reference of the Taskforce

In essence, the Taskforce's cardinal goals are the following:

To recommend to the Government a body of what can be called SME Policy in Industrialization for Bangladesh;

To redefine the criteria of eligibility to the assistance package in terms of size of the enterprises;

To identify, on some well-agreed rational bases, a number of industries with a sizeable proportion of SMEs which then to create an assistance-package for;

To produce a fairly self-contained set of implementation guidelines for the Taskforce's prescriptions to have lasting value;

3.0 National workshop on SME Development

A national workshop on *Development of SMEs in Bangladesh* was organized by the Taskforce on 20 February 2004 at LGRD Conference Hall and was represented by the prominent scholars, experts, government officials,

representative of the development partners, and members of the civil society of the country. Two keynote papers were presented in the workshop: One “*Tackling Stock and Charting a Path for SMEs in Bangladesh*” by Bangladesh Enterprise Institute, and the other one “*Entrepreneurship Development for Small and Medium Enterprises*” by Bureau of Economic Research, University of Dhaka. Six groups formed in the workshop presented their findings and recommendations. The compilation of the recommendations of the workshop has been distributed to the participants of the workshop for further comments. The individual comments and recommendations were discussed in the meetings of the Taskforce and finally, a drafting committee was formed to produce a draft report of the Taskforce on SME Development.

4.0 Objectives

The key objective of the report of the SME Taskforce is to make a constructive and hopefully lasting contribution to identifying *booster sub-sectors*, and then to the leveling of the playing field for SMEs, and especially for small enterprises in these booster sub-sectors. SMEs, especially the small enterprises must be offered an *enabling environment* for routine operation and growth, unhindered by the predatoriness of stronger rivals, to name one of the most potent anti-thesis of their survival.

5.0 Efforts of the Drafting Committee

What follows is the first draft of a report of the Small and Medium Enterprises Taskforce: it includes the outputs from various companion efforts in the appendices. While borrowing selectively from those companion output, the draft of this report has made an effort within merely a couple of week time-period to round out a theoretically self-contained, sectorally well-targeted, and articulated prescriptions for the policy-maker. The members of the drafting sub-committee are acutely aware that, while they have actively sought to give space to as many of the relevant threads of both analyses, discussions and recommendations from the companion output, they may have occasionally failed to capture *each item* that was important. The drafting sub-committee however feels that by including all of that valuable companion output in the body of the *overall*

report of the taskforce, albeit in the appendices, the reader has not been denied of the fruits of that fertile labour.

6.0 Methodology and Approach

6.1 A good deal of thinking and writing have taken place, especially since this Taskforce was formed in November 2003, on how to spur the growth of SMEs in Bangladesh. The scholarly activity produced several reports, including the report produced by the Bangladesh Enterprise Institute. That report, as also some other work done by scholars on the subject of SMEs, produce many conclusions that are well-informed and valid. The Taskforce is much in the debt of the authors of those works.

6.2 Having said that, it is imperative that we make it frankly clear that we have taken the liberty, whenever appropriate, to employ a different methodology formulating the vital question(s) of real interest. More specifically, we have chosen to adopt a slightly more focused, perhaps more specific, approach to what is action-able within the admittedly limited financial and implementation resources of the government. The distinguishing feature of our methodology has been a constant concern with *externally-induced constraints that affects, or are likely to affect, SMEs only but not others*.

6.3 This “SMEs-only” global-view leads to side-tracking or totally omitting issues of a kind that affects alike both SMEs and large enterprises, for example. Given that the government is in any case likely to be starved of financial and managerial resources, the SMEs-only vantage-point appears to us to be more appropriate, both tactically and logistically.

6.4 We take pains in pointing out throughout where some of the other esteemed contributors, by using a more general approach, have been led to propound a significantly more expansive, more diffuse and less tractable package of assistance interventions for SMEs, compared with the one that we have put forward.

6.5 Let us give an example of what we have in mind here. The BEI writes: “Second, the government should be focused on creating an enabling environment comprised of *sound macroeconomic and structural policies, good infrastructure, fair policy of competition*, and efficiently functioning institutions (italics added). Economic policies should focus on creating a transparent and accountable legal and regulatory framework, a policy to improve quality and transportation system.” These policies will, if they are effectively implemented, increase the productivity, across-the-board, for **all** sizes of enterprises. How can they *alleviate the competitive deficit of the SMEs **versus** large enterprises?* An SME-only approach leads us to a more focused set of actions, with a more direct impact-route for SMEs’ constraints, is likely to address them in a clear and quantifiable manner.

6.6 The Taskforce has availed of a methodology that blends five best-practices, namely, (a) synopsis of *first-principles* that rationalize *public intervention of any kind*; (b) summary of deliberations from an intensive day-long workshop held in February, 2004; (c) the two reports produced by the BEI and BER; (d) lessons from case-studies of *market and government failures*; (e) stakeholder interviews (consultants, BSCIC, NASCIB, some real-life entrepreneurs currently engaged in SMEs); and finally (f) distillation of international best-practice.

7.0 Scope of the Taskforce

The scope of the work of this Task Force is about small and medium-sized enterprises in manufacturing industries or in trading or service-based ventures. The SME Taskforce puts forward a well-structured approach to the problem of identifying booster sectors, and “eligible” enterprises within them. With this, we now turn to the vision that has inspired the Taskforce.

8.0 Vision

The Taskforce believe that it was handed down a rare opportunity to make a difference, going forward, to the lot of SMEs in this country, draw up a tactical plan of action and finally a set of implementation details so as to spur small enterprises in a number of target industries. The period of the incumbency of this Taskforce has been one of thinking clearly about the vision and road-map for the development of SMEs. The vision guiding our work has included:

- a. That legitimately promoting SMEs---or, at the very least, keeping SMEs, especially the small enterprises *out-of-harm's-way* from the fierce competition powered by the large, formidably-branded, often multi-national, firms---would be widely accepted as an essential tenet of industrial policy of Bangladesh.
- b. Of the total resources available to SMEs, no more than 20% must be earmarked for the medium-sized enterprises, while the remainder, 80%, will be earmarked for small enterprises.
- c. Stake-holders of small and medium-scale enterprises shall run their business on a *level playing field* as regards the provisioning and pricing of each of the seven *make-or-break* inputs for any enterprise to compete, namely, **equity capital; debt finance; technical skills; management skills; marketing know-how; gainful information, especially updates about market prices and about technical-substitution possibilities;** and **capacity for continuous innovation.**
- d. Such stakeholders on the other hand must also be ready for any change-management that survival may dictate or agility may require; have a high degree of management commitment to success; and finally must be willing to give to success what it takes by way of intelligent, prudent but diligent work whenever necessary.
- e. There must be a minimum allocation certainly in the *development budget* for rendering *legitimate public assistance* to SMEs.

- f. That there will be an *Advisory Panel*, equipped with professional expertise, with a lateral *locus standi* within the Ministry of Industry, mining its expert knowledge, scouring the profit horizon for *the next big thing* that especially small enterprises could have a natural ability to excel in. This Panel must be funded reasonably, with regard to what it takes to carry out *rapid but knowledgeable appraisals*. Such a brain-trust will work like a *control-panel* for screening-in on an early-on basis the products that small enterprises could own to succeed. This body will be tasked to identify *thrust subsectors* to steer the focus of small enterprises. The Panel will also supervise the professional work to be done within the SME Cell, which currently exists in the Ministry of Industry.

- g. That inputs from service-organizations (technical, marketing and management know-how) will, whenever necessary, be accessibly priced and then be physically available when they are needed by SME businesses.

9.0 The drags the Taskforce faced

9.1 The Taskforce was handicapped by a paucity of statistical data evoking confidence in terms of the quantitative significance of SMEs in the national economy of Bangladesh. Comprehensive information as to the structure of industries where SMEs abound was also not available. Senior researchers from BIDS have pointed out that even data circulated by Bangladesh Small and Cottage Industries Corporation (BSCIC) regarding value added were deeply flawed. It is not just the case that necessary results were NOT to hand in terms of essentially descriptive characteristics of small enterprises (such as size, value-added per worker, capital per worker). The paucity of data and information was even more limiting as regards more substantive policy matters. The structure of costs, the relative importance of the sourcing of the inputs by small enterprises between domestic production *versus* imports, the *ex-factory* prices for small/medium firms of *imported inputs* (which can allow the calculation of the effective rate of border taxation of imports), etc, are some of the required data of substantial importance, which were virtually not at all available.

9.2 All too often, the members of the Taskforce were feeling as if we were on a mission to *plan without facts* or wage a war without maps. We had no evidence of certifiable authenticity as to which are the industries in which SMEs *on our definition* had prospered or withered. We had no firm evidence as to why they had prospered or withered. To the extent that *casual empiricism* led us to surmise that one or the other industry had seen their SMEs do well, there was no evidence at all to probe such episodes for their underlying drivers, for example, whether they had done well due to their ample wits, or they had done well due to public largesse (of cash subsidies, for instance). There was too little even of *the data*, not to speak of *information* or *knowledge* as to what are the *quantitative laws of motions of SMEs* in Bangladesh. Even NASCIB, the supposed association of small and cottage industries in Bangladesh, could not produce *any real data* purporting to show the business character of their avowedly 6,000 members. The situation regarding data was simply untenable, and cried for an early effort to alleviate its poverty.

9.3 Absent such any credible empirical basis for our work, we were reduced to depending on secondary research done by scholars, on abstract inferences we could reasonably make based on *a priori* theory, and on the accumulated practical work experience of a number of SME practitioners, both inside the Taskforce and outside. We freely admit that such an amalgam is scarcely an effective substitute for having and using hard results from seasoned analysts or analyses. Even so, we believe that, while not of a flawless pedigree, our recommendations are on the whole realistically actionable

10.0 Structure of the Report

10.1 The report is structured as follows: The main report is broken into three chapters. Chapter II essentially makes the point that in the wake of fairly accelerated trade liberalization, and the growing ascendancy of both China and India as manufacturing powerhouses, the small and medium enterprises (SMEs) in Bangladesh are exposed to the chills of *oversized* foreign competition like never before. This chapter is about the role of SMEs in development. Chapter III defines the SMEs for purposes of policy discussion going forward, and then highlights the criteria for *sectoral targeting*. This chapter also finalizes a

list of eleven *booster industries* that must become the focal point of a strategy for SME assistance in Bangladesh for the next three years. Chapter IV presents the policy and institutional recommendations of the Taskforce. This chapter also then issues forth a number of markers as to how the eligible *enterprises* are to be drilled down for. Chapter V presents the summary and conclusions of the report.

There are three appendices to the report. Appendix-1 presents the notification of the constitution of the National Taskforce on SME Development. Appendix-2 presents a detailed presentation of the *criteria for sectoral targeting*. Appendix-3 presents the recommendations of the groups that arose from the Workshop held on February 20, 2004.

Chapter II

ROLE OF SMEs IN THE NATIONAL ECONOMY

1.0 Trade Liberalization and Competitive Landscape

1.1 Bangladesh has liberalized conspicuously throughout the 1990s. As a result of this broad liberalisation, the overall orientation of trade policy in Bangladesh has altered considerably, in the process becoming significantly less protective and less biased towards import substitution activities and therefore less discriminatory against domestic exporters (and potential exporters). During the 1990s, the coverage of quantitative restrictions fell from 253 four-digit Harmonised System (HS) codes to 28, while the average tariff actually applied (based on total revenue collections) fell from 62.3 per cent to 23.0 per cent. Maximum customs duty declined from 350 per cent to 25 per cent during this period. In other words, Bangladesh has been a poster child of good, even docile, management of its trade and industrial policies.

1.2. Has this great effort yielded commensurate gains in terms of growth rates? The growth rates---of the GNP, the manufacturing value added, and trading sectors in the Bangladesh economy for four overlapping quinquennial periods beginning from 1976/77 up to 2003--- shows no evidence at all of a significant quickening of the rate of economic growth in any of the three growth indicators. Whereas, the differential between the rates of border taxation between the two period is highly significant. The clear implication is that trade liberalization is a necessary but no means sufficient condition of a significant acceleration of growth rate of any given developing country.

1.3. This is not the place for a fully-blown analysis of Bangladesh's trade and industrial policy. What we want however to do at the present time is to emphasize that with the dismantling of the protective tariff

structure, Bangladesh has become more *outward-looking* in how it sources its requirements for various products. An obvious by-product of that trend has been that *domestic manufacturing for domestic absorption* in which especially small and medium firms have a natural interest *may well have* declined. Business interest in making a quick profit from indenting and trading has been piqued, while successful domestic manufacturing has become very challenging indeed.^[1]

1.4. It is in this context that the recent policy interest in the SMEs has to be seen. In country after country, leaders have come to the conclusion that while accelerated trade liberalization is a necessary condition for creating an enabling environment for the broad-based growth of the manufacturing industries, the small and medium enterprises will require well-targeted assistance package, especially in terms of credit availability, skilling-up and mentoring on how to make most of the opportunities that an *outward-looking regime of trade and industrial policies can unleash*. This recognition has been instrumental in spawning in the recent times an urgent and sustained interest in the SMEs as building blocks of adjusting to the radically different market and policy scenarios in the post-liberalization era in Bangladesh.

1.5. It cannot, of course, be gainsaid that rapid trade liberalization has a knack for providing globally companies or globally-branded countries (such as China and India) a breakthrough for well-orchestrated penetration by their own products into debt-dependent countries in which SMEs are still in their infancy. Their capitulation is quick before the avalanche of imports of products from globally-branded competitors, at times from prices that suspiciously look *like dumping*, from countries that typically are capital-surplus. (A lot of the penetration by imports into Bangladesh by China and India in several lines of products is due to the formidable marketing clout of firms in the latter, not necessarily because the product was always of superior quality or most cost-effective.) Consequently, imports of the liberalizing countries can grow much faster than their exports ever can, given the non-price market barriers in the developed countries. In Bangladesh, imports payments have grown at a rate of 24% between 1988/89 and 2002/3, while exports have only grown at a rate of some 17% annually. The differences between those two growth rates are statistically highly significant.

1.6. While liberalization may well have created opportunities for gainful growth through trade on the demand side, such gains, going forward, must be seen as counterbalanced by formidable challenges on the supply side. First, competition has become increasingly fierce among the global and regional economies and enterprises, SMEs included. There are also many more producers competing for both existing and new markets and market segments for goods, services, finance and other wealth-creating technologies and knowledge. The competitive strength of China was notable in the above regard, even before the country became a member of World Trade Organization in December 2001. Indeed, market penetration and displacing pressures from China have been keenly felt by producers across Asia, particularly those suppliers (including SMEs) at lower stages of technology sophistication and relying on a high import content. At the same time, the fairly meteoric ascendancy of India since the turn of the century as a magnet for direct foreign investment (DFI), and the outsourcing of much design and development work from the OECD countries in industries as diverse from movie-editing to chip-design, is a sign, increasingly ominousness for competitiveness, of the present times.

1.7. Second, consumer preferences and market standards have become more sophisticated and exacting. Competitive advantage is now determined by several non-price parameters such as quality, health and safety, social equity in employment and production, and ecological compatibility of products and processes. Furthermore, market demand is constantly changing, a trend facilitated not least by the rapid advances in ICT, bio-engineering and new materials. In consequence, there are more frequent introductions of new products and processes, faster and more innovative design changes, shorter product cycles and smaller output batches, higher quality and greater mass customization, more just-in-time sourcing and greater punctuality in delivery. This is the context in which we are having to draw up a strategy for reviving the flagging SME sector in Bangladesh.

2.0 Role of SMEs in the National Economy of Bangladesh

2.1. According to UNESCAP, SMEs account for upwards of 90% of all firms in East and South-East Asia, as well as in Japan (Wattanapruttipaisha, 1999). It is also the biggest source of the region's employment,

including three-quarters of the region's employment, in particular its women and young workers. The relative share of SMEs in total output and exports is typically much smaller, close to a third, or so. In Bangladesh, large enterprises account only for a small percentage of all business enterprises. The percentage is much smaller in other than manufacturing than in manufacturing *per se*.

2.2. The manufacturing industry essentially comprises small and medium scale enterprises: by some accounts, 60% and 25%, respectively, of the workforce in manufacturing happen to be hired by small and medium enterprises. It is hardly an overstatement to say that small and medium enterprises are pretty much synonymous with manufacturing industry.

Table 1: Growth of Small-scale Industry Sector

Year	No. of Units		Employment	
	Small	Cottage	Small	Cottage
1981	24,590	321,743	322,110	855,200
1991	38,294	405,476	523,472	1,331,032
2001 (end of June)	55,916	511,621	808,959	166,724
Average Annual Growth Rate	6.4%	3.0%	7.6%	4.7%

Source: Adapted from Ahmed, 2002

2.3. The highlight of Table-1 is in the fact that the growth rate, between 1978 and 2001, of employment is somewhat higher than for the number of establishments.

Table 2 Small-scale Industries: how other-than-farming drives their structure

Industry Sub-sector	No. of Units, 1978		No. of Units, 1991	
	Number	% of Total	Number	% of Total
Rice Mills	12,242	51.00	13,482	35.21
Bakery	2,157	90.2	2,765	7.22
Flour Mills	1,315	5.42	1,718	4.45
Light Engineering Works	1,120	4.66	2,252	5.88
Printing & Publishing	995	4.14	1,775	4.64
Readymade Garments	757	3.15	2,365	6.18
Saw Mills	713	2.97	1,023	2.67
Soaps	143	0.59	351	0.92
Plastic Products	74	0.31	725	1.89
Automobile Servicing & Repairing	296	1.23	550	1.44
Total	19,822	82.6%	27,006	70.5%

Source: Ahmed, 2002

Note: The only aspect of this table that is hard to rationalize is the fact that the number of the establishments producing ready-to-wear garments should be as high as 757 as far back as 1978. As far as we know, the first ready-to-wear establishment in Bangladesh was in fact established only in 1977 or 1978. We suspect that there has been a significant over count of both the number of establishments overall, and in particular, of the number of garments establishments in 1978. If correct, this would imply that the growth rate presented in Professor Ahmed's paper of the number of establishments between 1978 and 1991 is a vast understatement.

2.4 Table-2 shows, on the other hand, is about what drives at least the numerical structure of the SSI with regard to the *composition of input and output*: in other words, with regard to structural change. Accepting at face value the numbers presented in that table, the proportion of establishments with their roots in agro-processing is seen to fall sharply during the period in question: from 65% to almost 46%. This is a change worth bearing in mind.

3.0 Role of SMEs in the export economy

3.1 A sector can contribute to export receipts in two ways, namely, (a) directly; and (b) through the production of intermediates, processed and semi-processed goods. How important are Bangladesh's SMEs in terms of their contribution to the exports receipts of the country?

3.2 No credible information was available to the Taskforce to answer this question convincingly. There is however a lot of stylized evidence for other economies that suggest that SMEs are the mainstay for employment and work opportunities within Asian countries. In India, for example, SMEs account for some 80% of all enterprises, whether registered or not: they account for some 35% of the production of exportable goods of that country. In some of the most export-oriented sectors, such as ready-to-wear apparels, the percentage of the country's exports from SMEs could reach pretty high figures (Box-1).

Box-1: SMEs in India's export effort

SHAF

Percentage share of SMEs in India's exports, 1998/99

Ready-to-wear garments	42.6
Basic chemicals, pharmaceutical and cosmetics	11.0
Processed foods	12.4
Engineering goods	8.6
Finished leather	8.2

Source: Mukherjee, 2002

3.3 Corresponding data are not really available for Bangladesh. Our own guesstimate is that for ready-to-wear garments and processed foods, the corresponding percentages would be close to 50-60%, and 65%, respectively. While more numerous data are not available, it will suffice for present purposes to say that SMEs in Bangladesh are also the very backbone of its economy to generate work opportunities especially for young people and females workers who want to work.

4.0 The Study by the International Consulting Group (ICG)

4.1 The only recent study which the Taskforce was able to lay its hands on is the draft report by Daniels (2003). There is no doubt that this is an important effort, as it analyzes data from 10096 enterprises

throughout Bangladesh. The findings presented in this report are, however, less than usable for the report of the Taskforce: Daniels aggregates micro, small and medium sized enterprise into one *catch-all* category. While one has a composite category that is the direct obverse of “large” enterprises, it does not come to be very handy in the case of an analysis, as in this particular case, concerned with small and medium enterprises. Ideally, we would have liked to have the results where the “micro” enterprises have been screened out.^[2]

4.2 Nonetheless, the following two tables from Daniel’s work appear to throw some light on what we have been trying to say in this report. The first of the table shows net profit earned by the sample enterprises, the latter being arrayed in order of their size (measured by the head-count). The result that leaps off the page is about an inverse association between *size* and *net profit per worker*: the large the enterprise, the less profitable it becomes. It is even correct to say that single-workers enterprises are the most profitable.

Table 3: Median net profits per worker per year by gender of owner and sector				
	Female Owners		Male Owners	
	Actual hours (Taka/work/year)	Full - time Equivalent (Taka/work/year)	Actual hours (Taka/work/year)	Full - time Equivalent (Taka/work/year)
Agriculture	6,800	10.014	8,917	11,118
Fishing			17,583	19,265

Manufacturing	6,908	8,350	19,796	13,657
Construction			21,000	19,220
Wholesale & retail trade and repairs	10,445	6,922	23,742	13,567
Hotels & restaurants	4,646	-567	17,793	6,794
Transport, storage & communication	13,475	4,197	31,938	18,104
Real estate, renting & business activities	13,788	13,293	19,850	12,219
Education			16,436	9,042
Health and social work	12,825	18,692	21,547	19,560
Other service activities	19,370	12,870	27,013	14,671
Overall Average	6,943	7,344	19,000	13,102

Source: (Daniel, 2003)

4.3 Daniel’s report as yet does not produce any cross-tabulation of *net profit results* in terms of both size and production of sector of origin, simultaneously. One could then delve a little deeper into these results. Daniel’s report also does not present any estimate as to the *capacity utilization* achieved by the various enterprises in the various situation. Absent such supporting analyses, it is not really possible to take our understanding very much farther than the fairly limited resolution of the issues that are really staring this Taskforce in the face.

4.4 This is one reason why the Taskforce believes it will be in the interest of SME policy work to have the data analyzed further, providing a breakdown between the “micro” and SME enterprises. Cross-tabulation of the data would also be of some considerable value. And finally, it will remain important to report the results of a variety of F-test on the data, in an attempt to perform testing of various hypotheses (that imply invoking null hypotheses of “no association”) on the data.

Table4: Median profits of MSMEs by size and gender of owner					
		Female Owners		Male Owners	
Size		Actual hours (Taka/work/year)	Full - time Equivalent (Taka/work/year)	Actual hours (Taka/work/year)	Full - time Equivalent (Taka/work/year)
Number Of workers	1	8,209	10,108	26,800	17,269

	2-5	5,571	4,795	17,833	11,247
	6-10	21,900	9,456	11,378	15,652
	11-20	10,862	10,418	14,800	12,458
	21-50	12,067	2,449	6,667	7,679
				6,313	8,030
	51-100				
Total		6,943	7,344	19,000	13,102

Source: (Daniel, 2003)

4.5 It is ***not a little*** striking that, while the smallest enterprises should be registering such *above-average* net profitability, they should also be the objects of such sustained discrimination compared with *larger enterprises* when it comes to the question of accessing bank finance, or benefiting from other kinds of patronage, or indeed *other service inputs* such as mentorship. If the smallest of the enterprises can return such pretty stellar performance living by their own wits and due diligence, their financial prognoses would obviously become even much promising if policy-makers and their market rivals would only allow the *playing-field to be just a little more level*.

4.6 Having said that, the Taskforce is obviously under no delusion that the smallest enterprises are unlikely to present the *most naturally advantageous point of intervention* for any *service-delivery* program, should one be considered. The average cost of delivery (per unit of service delivered) is likely to be *much higher* if the smallest enterprises were to be chosen as the *focal point of the intervention*. Economics would appear to dictate that it is the largest among the small enterprises, and the medium-sized enterprises in the *booster industries* which, by virtue of significantly greater absorptive capacities and greater scales of output

would, return *greater cost-effectiveness* in the results obtained. The Taskforce would return later to the *selection criteria* to be put forward as a part of its report.

Chapter III

DEFINITION OF SMEs AND IDENTIFICATION OF BOOSTER SECTORS

1.0 Definition of Small and Medium Enterprises:

1.1 Manufacturing Industries: For manufacturing industries, the Taskforce defines:

- (a) **Small Enterprise:** an enterprise should be treated as *small* if, in today's market prices, the replacement cost of plant, machinery and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and building, were to be up to Tk. 15 million;
- (b) **Medium Enterprise:** an enterprise would be treated as *medium* if, in today's market prices, the replacement cost of plant, machinery and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and building, were to be up to Tk. 100 million;

1.2 Non-manufacturing Industries: For non-manufacturing activities (such as trading or other services), the Taskforce defines:

- (c) **Small Enterprise:** an enterprise would be treated as *small* if it has less than 25 workers, in full-time equivalents;
- (d) **Medium Enterprise:** an enterprise would be treated as *medium* if it has between 25 and 100 employees;

Some rationalization of this twin definition now seems to be in order. First, it is believed that most small enterprises don't require very much of fixed capital---perhaps, in the vicinity of several tens of hundreds of thousands taka worth. For instance, in light engineering --- the archetypal kind of industry in which small enterprises abound---the cost of setting one up is almost always well within the mark of Tk. 15 million worth of investment. Second, a fabric-making establishment with a capacity say of some 5 million yards of output a year is only likely to cost up to Tk. 100 million by way of the replacement cost of plant and machinery to set up. While the first is an archetypal of the outer limit of what a small enterprise can take, the latter is representative of what a medium enterprise can take. Third, the decision to omit land from the definition of eligibility is easily defended: land in Bangladesh has been subjected to a valuation based on *speculation*, not market forces based on *cost-based analyses*: many entrepreneurs who self-select themselves into creating *enterprises* on their *own land* could be excluding themselves from legitimate *public assistance* if land were included. Fourthly, many entrepreneurs habitually think of the input of land into the economics of their own enterprises as a *service to be bought*, not owned outright.

2.0 Rationale for picking *booster-sectors* in Bangladesh

We now turn to considering the *rationale* for legitimate public interventions to promote the cause of SMEs in the growth of employment, investment and output in Bangladesh.

Where others have used the coinage of *thrust sectors*, we have chosen to go with *booster sector* (as in *booster rockets* in a multi-stage rocket). The latter seems to resonate better with providing a boost not just to the growth rate of the sector in question but also, through backward and forward linkages, to those of the associative sectors as well.

Before proceeding any further, we must address more fully as to why we concern ourselves with establishing the rationale for publicly intervening. Aren't these rationale common knowledge by policy-makers? Aren't they axiomatically accepted among the community of practitioners? What can prevent the Taskforce from coming directly to a short list of promising industries in which SMEs numerically abound? Are these rationale worth the trouble?

Discussions in various past workshops on SMEs evinced relatively scant exposure to these rationales for assistance. The Taskforce consider it to be a lapse. This is because any promotional strategy is, by definition, *prescriptive* (and not assertive). All too frequently, promotions claimed to be legitimate and necessary were divorced from any discussion of precisely *why* public interventions were needed in the first place. Because some sectors need to be *prescribed as more eligible than others* for public assistance (which has to be *earned on one reasonable criterion or the other*), it is imperative that prescriptive rankings be followed up with disciplined rationalizations: they allows a structured approach to a debate. If recommendations or prescriptions were *based on nothing more than personal value judgements*, this would invite a failure by design of the Taskforce. Prefacing our *prescription* with diagnoses in terms of some *failure of the system* or of some *over-arching* rationale (that runs in terms of *providing leadership to a myopic marketplace* to bring the *appropriate kind of structural change in the economy*) was accepted as a requirement.

3.0 Criteria of sectoral targeting

We present the detailed discussion of these rationales in Appendix-2 to this report. For present purposes, we merely present these criteria of sectoral targeting, in their bold relief. We believe the following are the main operative criteria:

- (1) Strong comparative advantage:** Sectors in which *factor endowments* are such as to confer strong comparative advantage compared with others qualify as a booster. Comparative advantage will be judged in terms of the sector's domestic resource cost (DRC).

- (2) **Rising demand:** commodities for which *marginal budget shares* are higher than *average budget shares* are those for which demand is rising at a *higher-than-average* rate.
- (3) **Backward and forward linkages:** Some processing industries---agro-processing is an apt example---can capture well forward and backward production linkages with other sectors.
- (4) **When the playing-field is not level:** Markets virtually never perform as in the text-books, but are frequently skewed due to vast economic inequalities, asymmetric distribution of information, knowledge, and social-networking connections. Careful public interventions are needed so that a broad symmetry of resources can be made to prevail.
- (5) **The need for structural transformation is not transparent to the uninitiated**
The technology shelf---the inputs, and how they can best be combined---and the demand-mix are not *static* but is evolving fairly continuously. This forces on markets the responsibility of signaling the *need* and, more difficult, the *nature* of structural transformation that can *facilitate* survival. In this context, ***Governments are supposed to have a superiority in terms of access to strategic information versus the private-sector.*** Based on this, the creation of *new institutional delivery chains* can legitimately be posited, to deal with the imperative of structural transformation in the economy.
- (6) **Structure of incentives: manufacturing vs. trading**
In globalization, the formidable market power of global brands result in a structure of economic and financial incentives in the market place that is inimical to the domestic manufacturer versus the importer. It is arguable that a similar shift in the business *mindset* is enveloping Bangladesh: trading is a safer, smarter, richer and bulkier business than domestic manufacturing is. Managing workforces is nightmarishly difficult, as technical workers are exceedingly foot-loose, and manually-skilled workers are fractious. Manufacturing requires a much greater presence on the ground, and visibility invites extortion in the semi-anarchic conditions in Bangladesh.

4.0 Identification of booster-industries

By now, we have identified all the *market and policy failures* that hobble the performance of the SMEs and have clearly expanded upon the rationale for various interventions recommended. It now remains to pick the industries to be recommended as *booster sectors* for a *time-horizon of, say, 3 years*.

The following are the industries:

Electronics/Electricals

Rising demand/intensively requires innovation

Software-development

Structural change/intensively requires innovation

Light-engineering and metal-working

Linkage effects/natural survivability

Agro-processing/agri-business/plantation agriculture/ specialist farming/tissue-culture;

Strong comparative advantage/linkage effects

Leather-making and leather goods

Linkage effects

Knitwear / Ready-made Garments

Rising demand

Plastics and other synthetics products

Rising demand

Healthcare and diagnostics

Structural change/rising demand

Educational services

Structural change

Pharmaceuticals/cosmetics/toiletries

Structural change/rising demand

Fashion-rich personal effects, wear and consumption goods

Natural affinity to female-centric entrepreneurship

5.0 The rationale for our selecting these industries

- i. **Electronics and electrical**-computer components, peripherals, stabilizers, UPS, amplifiers, switches, plugs, printed circuit boards (PCBs), etc.---is legitimized owing to *rising demand*, as they provide among the foundation of industrialization and urban development. Given the per capita income of Bangladesh, they are characterized by high degree of linkage effects: while their growth spurs the demand for investment goods required in their production (backward linkage), the forward linkage part is likely to come from requirement for repair/maintenance services.
- ii. **Software-development** is worthy of selection because they intensively use knowledge of digital and/or *web technologies*. This is therefore easily accommodated on the basis of *structural change*. Furthermore, the marginal budget share of software-services in the countries in the Western world---the engines of the global division of labor---is a lot higher than the ABS. This is therefore a industry facing *rising demand, too*.
- iii. **Light engineering and metal working** is an industry in which *local nature of the markets to be served* implies that the typical output batch is fairly small, compared with *minimum efficient scale* (MES) of globally-branded companies. This offers a certain extent of *natural protection from competition*. In addition, this industry is suffused with both backward and forward linkages.

iv. **Agro-processing/agri-business/ agriculture plantation /specialized agriculture** industry in Bangladesh has a future for itself. Its selection is anchored in *strong comparative advantage* and *rising demand*. However, the Taskforce would recommend that it had better be the agro-processing industries of the *non-traditional type*, of the kind that moves away from rice milling and flour milling. We need agro-processors who essentially meet the following criteria:

Intensively use farm produce that boast plentiful marketed surplus, and in addition are complementary to fixing nitrogen in the soil;

Have enterprises and entrepreneurs who can deal with what it takes to successfully negotiate the hurdles implied by increasingly rigorous phyto-sanitary, and other epicurean restrictions in the importing countries;

v. **Leather and footwear** is driven by the recognition that the livestock sector in Bangladesh has ways to go in terms of matching the yield rates even in neighbouring India---not to speak of China (where they are even higher). This suggests that leather production in Bangladesh has ways to go. Clearly, the production of footwear, in large part for exports, is a natural ambition for a SME roadmap. This industry is really suffused with backward and forward linkages.

vi. **Knitwear** can be rationalized in terms of *rising demand* and *strong comparative advantage*.

vii. **Plastics and other synthetic products** (such as resin) have been known to lead factor substitution, and has been selected on this basis. This sub-sector has registered among the highest growth rates of any, according to Table-2 in the above.

viii. **Healthcare & Diagnostics:** The Taskforce recommends this subsector largely based on its rising demand domestically. Moreover, growing size of domestic market for specialized diagnostics has started to create opportunities for *legitimate import substitution*.

ix. **Educational Services:** Bangladesh is clearly surplus in human beings. To convert human beings into human resources must surely be a service industry worth hundreds of billion of Taka worth of potential market size. And quality education that keeps successfully following the *money trail* meets the bill of both *rising demand*, and *structural change*.

x. **Pharmaceutical, cosmetics and toiletries:** In 2005 and beyond, Bangladesh is one of the few countries in South Asia to benefit from an exclusion from the patent regime being globally introduced by World Trade Organization (WTO). This by bringing forth some significant competitive advantages of pharmaceutical companies will likely create opportunities, especially in the medium-enterprise category, for that industry in Bangladesh. It is important therefore to accent public assistance in that particular direction in order to take advantage of such a market possibility.

xi. **Fashion-rich personal effects, wear and consumption goods:** The Taskforce accepts at least one booster sector to be selected based on the need to concentrate efforts for promoting women entrepreneurs. The Taskforce believes that when it comes to leadership in matters of aesthetics, fashion and design delicacies, women entrepreneurs have an innate advantage.

Chapter IV

OBSERVATIONS AND FINDINGS OF THE TASKFORCE

1.0 The “vulnerabilities” of SMEs

1.1 Many authors, including from India, have drawn up list of various vulnerabilities of SMEs. And once again, it is clear that such lists merely recount where SMEs falter, without making a distinction between where they falter due their own intrinsic weaknesses (justifying no public interventions) compared with where they falter due to *market or policy failures, or due to non-existence of markets, or due to increasing returns to scale*. This becomes quite clear from an examination of the following two boxes (box-2 and box-3).

1.2 If SMEs have to make a difference, they need to be competed on an even basis. The undeniable fact however is that there is a seemingly unbridgeable chasm between the competitive situation (capital, information, access to the powerful, educational attainment, etc) between the small and large enterprises. (Markets are thoroughly imperfect and large firms dwarf SMEs in terms of *supra*-market influence and power.) Besides, it is also undeniable that a collapse in the cost of communicating across vast distances has tended to *unify global markets* like nothing before, as has a growing homogenization of consumption preferences: both have made competitive pressures even more intense. This has transformed the market dynamics, of which large as well as SMEs are merely parts. The competition is more chillingly intense now; the product life-cycles are shorter; production batches are smaller; information and communications technologies (ICTs) are much more of defining characteristics of a contender that counts. All of these add to the pressures under which SMEs have to operate.

1.2 According to Bangladesh Enterprise Institute, the following are the constraints to the growth of SMEs in Bangladesh:

Box-2: Common constraints to the development of SMEs in Bangladesh

1.	Lack of capital Lack of adequate investment; Lack of modern technology; High rate of interest on bank loans;
2.	Inadequacies of physical infrastructure Irregular/inadequate supply of power; Poor physical infrastructure and high transportation cost; Poor information about market opportunities and requirements.
3.	Inadequacies of markets/incomplete markets Inadequate availability of raw materials; Lack of skilled technicians and workers; Lack of research & development facilities;
4.	Other hostile/inimical conditions Fierce competition; Absence of effective and transparent legal system.

Source: Bangladesh Enterprise Institute, 2004.

Note: The headings and categorization have been suggested by the Taskforce, (even though the individual issues are the creation of Bangladesh Enterprise Institute).

Box-3	Common constraints to the development of SMEs in India
	<ul style="list-style-type: none"> Low capital base 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

The similarity of the two slates of “presumed constraints” is close indeed.

1.3 Only some of the entries in box-2 and 3 above have a blow-by-blow equivalence or correspondence to *market failures* or *government failures* or any of the other well-agreed *raison d’etre* for public interventions in markets. Not each one of these really amounts to a market failure which hobbles SMEs ***only and not large enterprises too.*** For instance, poor infrastructure in Bangladesh ails large firms too, as does the absence of an effective and transparent legal system. Of course, large firms don’t allow these *generically-relevant* handicaps to put a crimp on their operating results. But that may simply be because they have *preferred access to credit markets or capital markets*---privileges that SMEs *don’t have*. It is credit markets in this case

that *fail with sectional handicaps*, thus rationalizing public interventions *with sectional constituencies*: not public infrastructure. The implications are crystal clear: a pitch for more investment on public infrastructure does not really belong in as SME-only slate of public interventions. A pitch for making more financial resources available for channelling into SME financing clearly belongs there.

1.4 This is not to say that SMEs won't benefit financially if infrastructure were to be improved. They would. Point is that investment on infrastructure would benefit *all sizes of enterprises: it is unlikely to remove what handicaps SMEs from competing evenly against large enterprises*.

1.5 Another test is where it is possible to *exclude* firms in other than the target category from benefiting from the interventions in question. This test spells the difference between generic vulnerabilities (which strictly don't warrant ameliorative interventions with sectional targets), and vulnerabilities that result from *discrimination* in the market-place or failures of policies (which do warrant them).

2.0 Catalogue of market and policy-failures

2.1 The Taskforce have therefore exercised its prerogative to put down a handful of handicaps which affect SMEs *differentially* compared with their competitors. They appear in box-4:

Box-4: The Taskforce's own diagnosis of the most important rationale for action

Lack of capital

Utter scarcity of social venture (equity) capital, where pay-back period is long;
Constrained allocation of bank finance;

Tax administration

SME *manufacturers* are dealt an unfair hand by the NBR compared with their trading competitors.

3.0 Lessons from international experience

The Taskforce has been benefited from the assimilation of several major lessons from recently-concluded Ministerial Conference on SME Development in Istanbul, held under the aegis of the Organization of

Economic Cooperation and Development (OECD). Several of the most important lessons are as follows:

2.2 Because a considerable extent of strategic stewardship and gap

filling---with the gaps in question not being visible to the private decision-makers--- is typically required in this kind of structural transformation, a three-way set-up, involving the government, civil society and the private sector, is typically required. Only the government can be entrusted the central role of the architect of the change management, with the provision that it will formulate a broad plan of actions and then a much more detailed action programmes in the interest of execution. Government and civil society institutions in question typically also needs technical assistance and capacity building so as to attain maximum cost-effectiveness. That is why such improvement in the competitiveness of SMEs versus large enterprises typically requires a modification of the structure of public investment in desired directions. The policy and institutional-delivery set created for the development and empowering of the SMEs should be promotional, catalytic, incubatory and selective, and should not involve indiscriminate subsidies. To the extent that removal of specific market failure or previous government failure or negative pecuniary externality puts a premium on the creation of a package of financial incentives, then perhaps a small quantity of subsidies may also be justified. There is precedent in Asia of well-directed government intervention in a coherent package of ameliorative and stimulative action, including of channelizing strategically-focussed and small dose of financial subsidies, in the interest of fostering the growth of SMEs. Perhaps, a similar case can be made for SME development in Bangladesh, too.

2.3

It is important to foster the evolution of a congenial, transparent and simplified *regulatory* framework that keeps low the compliance costs of an enabling environment for SMEs, and especially small enterprises. By avoiding invasive procedures (such as rent-seeking behavior, etc) and keeping cost of compliance low, many countries have integrated informal-sector enterprises in mainstream SME development.

4.0 Elements of SME policy

4.1 Development of SMEs is increasingly being held at the highest echelons of policy-making globally, as a permanent and integral part of **poverty-reduction strategy** of the governments of developing countries. Success here will require acting decisively in terms of making SMEs' scarce financial resources go further, and harnessing, up to the hilt, human resource and institutional capacities of the stakeholders in SME development.

4.2 The archetypal small-ticket manufacturers, often closely associated with occupational categories with a social accent, such as *jolhas*, *tellis*, *sonars*, *kamars*, have been crowded by middle-class elite, and this denial and the associated divide calls for a correction through proactive intervention.

4.3 With liberalisation apace, withering competition from more entrenched countries and globally-branded companies operating on a global scale, and with deviations from the *rule of cascading* in the setting of border tariffs, trading has become a career of choice in Bangladesh at the expense of manufacturing for many who would have otherwise worn happily the mantle of a manufacturer.

4.4 There are systematic handicaps which choke the SMEs' entrepreneurial drive or put a crimp on their choices, and thus drag their net performance, *versus* their competitors'---thus justifying prescriptions which selectively impact SMEs in an effort to alleviate, if not remove altogether, such handicaps.

4.5 In an age of sweeping globalization, and growing penetration of information and knowledge technologies into the emerging international division of labor, appropriately positioning Bangladesh's SMEs in the resulting structural transformation of the global economy is seen as an important basis for both selecting the booster industries as well as the enterprises deserving injection of public assistance that benefit them.

4.6 While governments often perform poorly in production, they have (or at any rate can potentially acquire at low cost) an innate advantage in terms of acquisition, dissemination and maintenance of a base of information and knowledge of a kind that enhances productivity of private investors' business decisions in an inclusive manner. In addition, governments by virtue of its vastly superior catalytic or mobilizational potential have ameliorative role(s) to play when either markets fail, or externalities skew private investors response in sub-optimal ways or when venture-capital is in too short a supply for the nation's good in high-risk-high-gain investment opportunities. In such cases, there is a well-grounded rationale for public intervention, including a provider of equity capital, a practice in which a modest beginning has already been made in Bangladesh.

4.7 It is very important to know what the elements of SME policy are. The main ones require that:

- (1) the government accords to SME development an integral and vigorous role in the overall management of growth and poverty-reduction;
- (2) identify and establish the network of infrastructure and institutional delivery mechanisms that facilitate the promotion of SMEs;
- (3) especially existing regulatory framework and government support institutions be re-oriented towards bolstering the goals of SME policy;
- (4) nurture and partner civil-society institution(s) having credible management teams in terms of the delivery of needed services, leadership, initiation, counseling, mentoring and tutoring; etc.

4.8 Create innovative but meritocratic arrangements so that deserving and especially small enterprises with desired entrepreneurial antecedents and promise can be offered financial incentives within industries prescribed on some well-agreed bases.

4.9 Dispute settlement procedures should proactively shield small enterprises especially from high legal costs and insidious harassment.

4.10 In order to assist small enterprises in dealing with their pervasive lack of access to finance, avenues of mobilizing debt without collaterals to match (either using *debt-guarantee schemes* or mapping *intellectual-property capital* into *pseudo-venture capital*) must be urgently created.

4.11 There is a need to systematically accord precedence to small enterprises *versus* medium enterprises, within the limitations of government's resources.

4.12 Governments are increasingly harnessing information & communications technologies, Internet Protocol (IP)-based infrastructure, and electronic-governance in an effort to parlay regulatory services, all kinds of useful information and mentoring inputs, with an accent on increasing the viability of SMEs in all sectors of the economy.

5.0 Proactive Lending Package for SMEs

The credit crunch putting pressures especially on small enterprises must be alleviated. Towards this end, worthy business ventures in designated SME booster sectors should be declared eligible to loans that are carefully scoped and appraised for their bank ability. We recommend that BASIC Bank be declared the Lead Bank for the delivery of such credit on concessionary terms. (Over the medium term, the proposed SME Foundation would take over from the BASIC Bank the channelization of finances for SME development.)

6.0 Venture Capital

The Taskforce recognizes that the knowledge-economy has greatly increased the stakes to investments that are *outward-oriented*, have a high degree of intellectual-property (IP) content, and a high degree of *leakage* in the returns to such investment. Examples are software-development, manufacture based on the development of prototypes, creation of design leading to prototyping, enterprises naturally akin to creating intellectual-property, etc. In every case, there is an intractable degree of *seepage* of shareholder value: in economics, this refers to externalities. When externalities are outward, private rates of return tend to be lower than social rate of return, causing relative under-investment in such products or services. Gestation lag would on that account tend to be longer. Risk-averse private venture capital would likely be stifled by such longer gestation lag. Hence the imperative in such products or services for public venture-capital participation, so as not to stymie potentially remunerative private enterprise. Information-technology and electronics---two industries who in any case are closely inter-related---are prime examples of such negative externalities and, therefore, of such public venture-capital participation.

Such social commitment to the availability of *risk capital*, responding to the *special circumstances of technologically-nuanced* fields of enterprise development, is widely accepted as *effective practice* in India for example. The Small Industries Development Bank of India (SIDBI) has already set up a venture capital fund. Rating for possible funding is done using a thoroughly transparent and meritocratic process, overseen by a team of subject-matter specialists, who act independently and conscientiously. Such professional vetting is not challenged by the Chief Executive of SIDBI. The Taskforce recommends something similar for adoption in Bangladesh. We recommend that BASIC Bank be selected as the custodian of all social equity funding into SME development.

7.0 Restructuring tax-package for very small manufacturers

The Taskforce believe that for SMEs, the VAT by being collected *ex-factory* increases the likelihood of *double VAT taxation*. The onus of the proof of first-time VAT payment to the tax assesses, the SMEs, leads frequently to denial of payment-credit. The small enterprise does not have enough clout *vs* the large trader, who had sold him the commodity, to press his need for documentary proof about VAT payment at the border. The

small enterprise often ends up paying the VAT twice over on account of imported inputs. However, the most insidious part in all this is the nagging harassment by the officials, which leads to abject demoralization of the entrepreneurs who deserve better.

We recommend that small enterprises with fixed investment (without including land and building) of up to Tk. 3 million be declared completely exempt from paying any obligation to pay VAT. Manufacturing enterprises with fixed investment ranging between Tk. 3 million and 15 million (again excluding land and building) shall pay turnover tax at the rate of 2.5% (two and a half percent).

We recommend that such very small enterprises (with up to Tk. 3 million in fixed assets not counting land and building) should be given a tax holiday for 7 (seven) and 10 (ten) years from their initiation, for enterprises in the cities of Dhaka/Chittagong and all other areas/locations respectively. Both recommendations (a) and (b) will, we propose, be applied in **all** industries, not just the boosters.

India exempts all small manufacturing enterprises with capital investment under Rs. 1 crore from all types of excise duty. Besides, they have formed a separate Ministry for Small Scale and Micro-Industries.

8.0 No departure from the principle of *duty cascading*

At present, a UPS for computer is totally tax and VAT free if imported with a computer, and one has to pay only 7.5% import duty if imported separately. On the other hand for local production of UPS one has to pay 40% to 100% tax and VAT at import on different raw materials and spare parts.

VAT for imported UPS at the point-of-sale (POS) is zero. In sharp contrast, a local manufacturer is required to pay VAT at the rate of 15% per schedules prescribed by the NBR.

The same applies for computers and solar PV generator systems, almost all of which are electronic. Local capabilities exist to produce high quality UPS and the main electronic circuits for solar PV systems, but the Government tax policies have not only left the local producers unprotected, they did not even allow the local producers to play on a level ground. The existing policies also deterred local producers from attempting at producing or assembling any other parts of Computers and Solar PV systems. The suggested clauses will allow the local producers at least to play on a level ground, and will also deter such unreasonable reduction of tax and VAT on imported finished products.

The total incidence of all taxes at import (Import duty, Advance Income tax, Development surcharge, VAT, etc.) on the raw materials and spares of locally produced commodities must not, owing to the generally-accepted principle of *cascading*, exceed that on corresponding finished imported commodities. If such taxes for a finished commodity are reduced at any time, then the taxes on the raw materials and spares of that product will automatically stand adjusted following the above principle.

If VAT at sales is waived or reduced on an imported finished product, the total VAT collected for the same product at the point of manufacture and at the point of sales shall not be more than the above VAT at sales for the imported product, and this will also be activated automatically.

9.0 Medium-term Tactical Plan of Action

A tactical plan of action is needed preparatory to ensuring that an enabling environment is created in which both extant and aspiring SME entrepreneurs find within an easy reach most of what they direly need---information, counseling, mentoring, access to finance, and marketing and technical assistance.

More specifically, the tactical plan will entail articulation of delivery chains for *technopreneurship*---a hybrid using functioning entrepreneurship in technologically-steeped lines of productive ventures to produce goods which enjoy high marginal budget shares but also demands mentoring in incubators---some kind of a crucible where the green young are moulded into increasingly savvy entrepreneurs under the watchful oversee of the veterans of industry.

10.0 Capacity-building

A capacity-building package will be needed to keep the process of SMEs development speeding along.

The tactical plan aiming at creating an enabling environment with regard to the availability of information, counseling, mentoring, access to finance and markets will be needed.

Fostering a *supply chain for technopreneurship* will be emphasized. Towards this end, mobilization campaign will need to be mounted to spur interest by intelligent and diligent people in careers of successful entrepreneurship. The SME Panel/Cell might usefully conceive programs in popular media, and motivate appropriate anchor(s) for them, modeled after some highly-regarded success stories.

The Taskforce would like to recommend a ground-breaking approach towards bonding and harnessing an entire **online-community** of both extant and aspiring SME entrepreneurs, to be hosted on a SME portal in the SME Cell, for the divining of technology, product and market trends, for career-counseling to benefit science/technology graduates, for technopreneurial problem-solving, for mentoring using *guru-shisya symbiosis*.

A Web-based virtual *front-office* providing all start-up assistance to SME entrepreneurs (application forms, FAQs, limited directory-assistance, success stories, horror stories, etc): an *one-stop-service*, with all interactions between the user and the system stored on databases in the interest of providing institutional memory.

Information regarding standards of labor and output pertaining to overseas markets to benefit export-oriented SMEs should be put on the Web portal.

A high-performance fiber-optics communications backbone be put in place in all six of the country's largest metro-markets (namely, Dhaka, Chittagong, Rajshahi, Khulna, Sylhet and Barisal) so that SME entrepreneurs there can increasingly be in sync with the fundamental drivers of competitiveness in the new economy.

We all know that technology now enables the migration of the cluster eco-system(s) to Web-based structures and communities, in which the MOI and other stakeholders can be motivated to create *portlets* conducive to sharing of SME-friendly content or *knowlets*: here, information and communications technologies will need to be pressed into service.^[3]

11.0 Availing of the principle of *locational self-selection*

The old-quarters within large metropolis such as Dhaka and Chittagong hum with much small-scale production. This is where most of the production clusters in which SMEs abound can be found. Clusters are like eco-systems in which the small entrepreneurs have themselves forged a certain, mostly highly intelligible, division of functional specialization over many years of time. Sometimes, these output hubs also migrate towards the suburbs, to escape the crush on narrow roads. Either way, targeting these small, own-account proprietors, whose own lives often typify rags-to-riches stories emphasizing sheer hard work, is one way to press into service the first-principle of *self-selection*. *The rich does not go to inner city to make a living*: this in one line is the epitome of justification for what we have just said about self-selection. Entrepreneurs who try to make a living within the crush, the congestion, the crime and the foul smell of the inner cities in any of the nine booster industries certainly pass the first principle of *locational self-selection* to qualify for some measure of public assistance.

12.0 Training

BSCIC---mainly in the form of SCITI---, BIM and BITAC are all institutions in the MOI with a great deal of past investment in equipment, infrastructure and trained human resources. It is agreed that currently a fair proportion of these resources are inadequately utilized. The OECD has emphasized that quickly enhancing human resource and institutional development capacities is a *sine qua non* of letting SMEs contribute their fullest towards poverty generation in the current globalization scene. BSCIC/SCITI, BIM, and BITAC should undergo a significant strategic reorientation of their own core competencies under the watchful eye of the Advisory Panel/SME Cell. In particular, the skills and competencies needed to enable SME hold their own in the booster-industries in the changed global business environment should be re-emphasized in the ensuing revamping of these institutions.

Towards this end, technical assistance and investment are both urgently needed to appropriately accent the training and motivational in these institutions so that they can become durable fixtures of technical and managerial skills can be nurtured, in a format of public-private partnership.

Chapter V

TASKFORCE'S RECOMMENDATIONS

1.0 Identification of Booster Sectors

The following industries, including one based exclusively on the imperative to foster women entrepreneurship, are prescribed by the Taskforce for *preference* in terms of prospective public assistance and capacity-building programmes, within the limitation of a review every three years:

Electronics and electrical;

Software-development;

Light engineering and metal-working;

Agro-processing/agri-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;
Pharmaceuticals/cosmetics/toiletries;
Fashion-rich personal effects, wear and consumption goods;

Notwithstanding the prescriptive nature of the foregoing recommendation, non-classification as such should not disqualify an SME from financial assistance from any scheduled banks.

1.0 Policy recommendations

The Taskforce has organized its recommendations in three groups in order of their underlying time-horizons: short-, medium- and long-term.

- a. By short term, we mean actions whose impact may be felt between now and 18 months away.
- b. By medium term, we mean actions whose initiation could take up to 18 months, whose fruition could well take between 18 month and 4 years.
- c. Long-term is defined as something that takes more than 4 years to fructify.

3.0 SHORT-TERM POLICIES

3.1 *Framing and carrying out policies for SME development*

- a. The Government shall make an unambiguous **policy statement** declaring that the Government consider SMEs, especially small enterprises, as an integral and important element in the cause of economic growth and poverty alleviation in Bangladesh.

- b. An **SME Advisory Panel** shall be constituted to perform the services of a *specialist brain-trust* for the Ministry of Industries (MOI). Likewise, an SME Cell shall be set up in MOI to help implement the SME policies. The present SME Taskforce shall continue to exist so as to monitor the state of the implementation of its recommendations.

The Panel may comprise a few of the members of this Taskforce, other subject-matter specialists representative of the booster industries themselves, one or two certifiable role models of mass awareness-raising to generate mass interest in technopreneurial careers. In the medium term, the Advisory Panel and the SME Cell will eventually morph into what we call a **SME Foundation** (this is further detailed under the rubric of medium-term recommendations of the Taskforce). The Panel will report to the Minister of Industries. The tactical plan of action is about what it will take to move SMEs forward the way they should.

- c. A **roadmap** and a **tactical plan of action**, may be conceived and then detailed by **SME Advisory Panel** and the **SME Cell**.

3.2 Definition/Identification of SMEs

Defining enterprises for targeting purposes in terms of either fixed investment or head-count is a well-established policy practice, for instance in India. A one-attribute definition typically reduces the proportion of *indeterminate* cases compared with a two-attribute one. Any definition, no matter how well-thought-through, is bound to involve some degree of arbitrariness.

- a. For **manufacturing** industries, the Taskforce recommends that:

- ◆ **Small enterprise:** an enterprise should be treated as *small* if, in today's 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 buildings, were to be up to Tk. 15 million;
- ◆ **Medium enterprise:** an enterprise would be treated as *medium* if, in today's market prices, the replacement cost of plant, machinery, and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and buildings, were to be up to Tk. 100 million;

a. For **non-manufacturing** activities (such as trading or other services), the Taskforce defines:

- ◆ **Small enterprise:** an enterprise should be treated as *small* if it has less than 25 workers, in full-time equivalents;
- ◆ **Medium enterprise:** an enterprise would be treated as *medium* if it has between 25 and 100 employees;

By making the definition especially of small enterprises more inclusive with a lower threshold for assistance eligibility, the outreach of SME policy for poverty alleviation and employment generation has been augmented *versus* all past statements of industrial policies.

Proposed definition sets the threshold smallness at a much lower level compared with the treatment in the existing Industrial Policy of Bangladesh. The Taskforce recognizes that there will remain a need for National Board of Revenue (NBR) and other implementation arms of the government to incorporate the definitions in the declared SME policy within their own operating environment.

3.3 Setting criteria for deserving enterprises

Enterprises which, as well as meeting the size requirement proposed by the Taskforce, shall have

- a. proven credentials as an entrepreneur (for example, membership in well-recognized social occupational groupings, successful track record) with requisite presence and facilities on the ground;
- b. an above-average *insiders' equity participation*;
- c. certifiable professional specialization of top-management in relevant production skills;
- d. the stamp of approval from globally-recognized quality-assurance bodies (ISO 9001:2000, for example);
- e. High management commitment to innovation.
- f. Women entrepreneurs will be accorded preference, wherever appropriate.
- g. Other things being equal, smaller enterprises shall be given preference in terms of benefits from interventions by the government and civil society initiatives.

3.4 Rationalization of VAT and other budgetary measures

- a. We recommend that very small manufacturing enterprises with fixed investment, excluding land and building, of up to Tk. 3 million (three million), should be completely exempt from any obligation to pay VAT. For manufacturing enterprises with fixed investment, excluding land and building, of greater than Tk. 3 million and less than or equal to Tk. 15 million, there shall be a turnover tax will be 2.5% (two and a half percent).
- b. We recommend that such very small enterprises (with up to Tk. 3 million in fixed assets not counting land and building) should be given a tax holiday for 7 (seven) and 10 (ten) years from their initiation, for

enterprises in the cities of Dhaka/Chittagong and all other areas/locations respectively. Both recommendations will, we propose, be applied in ***all*** industries, not just the boosters.

Exceptions:

The above two facilities will not be given to:

- (1) Joint Venture industries with foreign partners,
- (2) Sectors that should be discouraged based on health, environment, or other grounds such as tobacco, liquor and narcotics related industries.

d. We recommend two blanket clauses to protect local industries from irrational tax policies:

- (1) The total incidence of all taxes at import (Import duty, Supplementary Duty, Regulatory Duty, Development surcharge, VAT, etc.) on the raw materials and spares of locally produced commodities cannot exceed that on corresponding finished imported commodities. If such taxes for a finished commodity are reduced at any time, then the taxes on the raw materials and spares of that product will automatically stand adjusted following the above principle.
- (2) VAT on imported products shall not be less than that on like domestic products. Any reduction in existing VAT on imported products shall be automatically matched by an equal reduction on VAT on like domestic products.

3.5 Levelling the playing-field in credit and venture-capital markets

- (1) A credit-distribution package will need to be worked out by the Ministry of Industries. An innovative scheme---rather like a two-stage screening mechanism---that can really probe for the *bone fide* of the applicants as entrepreneur material will be deployed. Donor financial resources made available specifically to help with implementation of SME policy being enunciated here would only be allocated to competitively-selected enterprises within the booster industries here being prescribed.

- (2) Of the total resources available, no more than 20% may be earmarked for medium enterprises, while the remainder, 80%, will be earmarked for small enterprises. Within each division, the resources will be divided up into a public-sector venture-capital fund (10%), approximately on the lines of the currently-implemented EEF at the Bangladesh Bank. The remainder will be allocated to a *credit fund*. (This does not have anything to do with debt-equity ratio relevant in discussions of enterprise financing.)
- (3) In the short run, the distribution of the credit fund and venture-capital fund will be the task of the BASIC Bank, which is here being recommended as the lead bank, it being borne in mind that BASIC Bank will closely work with the Advisory Panel. (Over the medium term, this responsibility will devolve to the SME Foundation.)
- (4) The Ministry of Industry and the SME Advisory Panel/Foundation, as the case may be, will determine modalities of how to implement both the credit-fund and the venture-capital fund.
- (5) Projects to be funded from the venture-capital fund will be evaluated by a team of experts---a handful of subject-matter specialists---which will be constituted as a part of the implementation of SME Policy.
- (6) A publicly-mandated venture-capital scheme be created in deference to the rationale cited in the main text. It will also give a stimulus to the morale of entrepreneurs who commit in-house capital to projects with novel and potentially innovative processes and technologies with demonstrable potential for commercial success. Such projects have a-typically high risk and high returns. This recommendation is rationalized in terms of the private under-investment based on extensive, even potentially crippling, negative pecuniary externalities in some among the booster industries prescribed here, with regard to the leaching of shareholder's value outward from the enterprise.

- (7) The Advisory Panel working together with the Lead Bank in the short-term, and the SME Foundation in the medium- and long-term, would implement a transparent and meritocratic arrangement for steering public equity and debt resources into a genuinely deserving selection of enterprises.
- (8) The development of human resources in both the BASIC Bank and the SME Foundation with regard to effective targeting of resources made available under public equity funding would remain imperative.

3.6 SMEs need for quality-assurance (QA) stamp-of-approval

- a. Bangladesh Standards and Testing Institute (BSTI) with its accountability to SMEs fundamentally enhanced through appropriate SME representation in its governance might become the focal point for offering assistance with regards to securing *quality-assurance (QA) certification from registrars of QA*.
- b. Suitable SME-related industry association(s) should be empowered to issue non-mandatory certification, albeit with high professional integrity, with regard to quality assurance. Such association(s) would be eligible to grants from Government towards the cost of setting up required testing laboratories and other facilities.
- c. Small, out-right co-financing grants may be available for registration with globally branded QA registrars (say with ISO 9001: 2001 or equivalent).

3.7 Multi-stage sample survey of SMEs

There is an urgent need for a major overhaul of the availability of reliable and current *data* about the characteristics of SMEs. The Taskforce recommends that the Ministry of Industries immediately take up the conception and implementation of a *multi-stage sample survey of SMEs in the metros and the district headquarters*. Ideally, there should be a complete enumeration of all SMEs, the data from which should be of use in drawing up a survey methodology for a systematic stratified random sampling.

4.0 MEDIUM-TERM POLICIES

The OECD have recently opined that one of the major challenges of transitional and developing countries in this age of sweeping globalization is to ensure rapid development of the SME sector by harnessing *scarce human and institutional capacities* in availing of trading and investment opportunities. In consonance with this imperative, the Taskforce puts forward a package of medium-term recommendations.

4.1 The formation of a *Small and Medium Enterprises Foundation*

- (1) Over the medium term and beyond, the Government **must** remove all remaining obstacles impeding the formation of an SME Foundation. While the Ministry of Industry will still remain the sovereign source of all policies, the proposed SME Foundation will become the focal point for all planning, developmental, financing, awareness-raising, incubation, advocacy, monitoring and evaluation services in the name of all SME development as a crucially- important element of poverty alleviation.

4.2 A tactical plan of action that leads to enabling environment

- i. The tactical plan is needed to move from *gap analyses* to *skills upgrading* based on the product(s) in the booster-sectors identified in this report, paying careful attention to the requirements of the production clusters in the inner cities (such as Dholai Khal, Mirpur, and the like).
- ii. An enabling environment in which both extant and aspiring entrepreneurs find within an easy reach most of what they direly need---information, counseling, mentoring, access to finance, technology and the means to market.
- iii. A serious effort is recommended for fostering a *supply chain for technopreneurship*. Bangladesh needs role models that can get intelligent and diligent people excited about creating value through successful entrepreneurship. It is recommended that the SME Panel/Cell and the SME Foundation conceive programs in popular media, and anchor(s) for them to match, modeled after some widely-accepted success stories.
- iv. An online-community, availing of relevant information and communication technologies, of both extant and aspiring SME entrepreneurs, to be hosted on a SME Web portal in the SME Cell/SME Foundation, for the divining of technology, product and market trends, for career-counseling to benefit science/technology graduates, for technopreneurial problem-solving session(s), for mentoring using *guru-disciple symbiosis*. (*The Taskforce is fully aware that pulling off such innovation would require careful planning and nearly flawless execution*).
- v. A Web-based virtual *front-office* providing all start-up assistance to SME entrepreneurs (application forms, FAQs, limited directory-assistance, success stories, horror stories, etc): an *one-stop-service*, with all interactions between the user and the system stored on databases in the interest of providing institutional memory.

- vi. Information regarding standards of labor and output pertaining to overseas markets to benefit export-oriented SMEs should be put on the Web portal.
- vii. Such structures of electronic-governance should be supplemented, at least for a time, by human touch, with adequate budget to match, to physically attend to the needs of small entrepreneurs who take recourse to them. This is based on the recognition that a totally hands-off delivery of all requisite services to SMEs is an ideal whose achievement was likely to only happen in stages.
- viii. A high-performance fiber-optics communications backbone be put in place *in six* of the country's largest metro-markets (namely, Dhaka, Chittagong, Rajshahi, Khulna, Sylhet and Barisal) so that the launch of some serious ICT-centric applications to benefit e-governance to the profit of SME development is not unduly handicapped by woefully inadequate bandwidth.
- ix. Technology-exchange programmes between countries with similar stages of development, and with a similar maturity of the infrastructural development for SME development, in the interest of rapid technology transfer.

4.3 Formulation of a package of capacity-building and training

- (1) Specialized professional expertise in carefully-chosen niches that the Panel of Advisors recommends has potential for a broad-based replication. Such training can be so packaged to such high standards that the recipients feel motivated to pay up *user charges*, however minimal.
- (2) Re-skilling *boot camps* would need to be organized for each of the booster industries by rotation, with a view to provide periodic technology grounding in efficacious skills among workers in SMEs.

- (3) BSCIC/SCITI, BIM, and BITAC---where a lot of equipment, infrastructure and other resources are in place---should undergo a significant strategic *reorientation of their own core competencies* under the watchful eye of the Advisory Panel/SME Cell. In particular, the skills and competencies needed to enable SME hold their own in the booster-industries in the changed global business environment should be re-emphasized in the ensuing revamping of these institutions.
- (4) Towards this end (as stated above), technical assistance and investment are both urgently needed to appropriately accent the training and motivational in these institutions so that they can become durable fixtures of technical and managerial skills can be nurtured, in a format of public-private partnership.
- (5) The selection of such training courses and then the delivery of such training is an important instance of *public-private collaboration*.
- (6) R & D that lead to prototypes with a scope for replication in potentially high-impact product *niches* (eg in the field of mobile games, 3-D animation, or bio-optics, or the manufacture of computer-controlled industrial and medical appliances, or spurring the use of resin in new production applications, etc);
- (7) Curriculum of vocational training institutes be revised and reviewed to make it SME development friendly.

4.4 Evolving of an SME Eco-system: Issues of Institutional Delivery Chains

Two kinds of institutions are recommended, preferably for adoption by civil society role models/ catalysts, bearing in mind that these institutions will not be in the employ of the government.

- (1) The mission of the first kind is in trying to render stakeholders out of indigenous young science and technology graduates by bringing to their agenda for poverty alleviation the currently-missing *fulcrum* of technological innovations to improve the quality of life of the poor in Bangladesh.
- (2) The mission of the second is to achieve mastery over a rapidly-changing slate of IT skills, and to then quickly disseminate them among young self-starters, including in the university/polytechnic/colleges' stream, through a regime of online and "brick-and-mortar" interactions.
- (3) Efforts to accelerate the retention and promotion of women entrepreneurs should be strengthened.
- (4) Greater stakeholder involvement in the entire gamut of activities by way of SME development while maximizing the extent of ownership to be promoted.

4.5 Mitigating Impediments in clusters

One should make an effort to identify three or four promising *lines of production* in a handful of clusters in the metros of Dhaka and Chittagong, where small enterprises abound. Gap analyses that lead to the diagnoses of weaknesses that stymie their productivity should then be launched. Several *technical assistance studies* should then be aimed at these problems.

5.0 LONG-TERM POLICIES

5.1 Education and Generational Ethos

- (1) Bangladesh should increase the number, and enhance the quality of technical education in, the country's *polytechnic institutes* in the interest of increasing the number of entrepreneurs.
- (2) Content of a kind that seed, early on in the global-view of the children, the attractiveness of entrepreneurial careers should be pressed into service.
- (3) Similarly, the accent on mathematics, science and technology fare should be made stronger in the educational curricula of schools and colleges in Bangladesh.
- (4) A census of all small and medium enterprises in Bangladesh should be conducted. This is likely to require a very large investment.
- (5) The legal and contractual framework prevailing in Bangladesh often increases especially small enterprises' handicaps. A survey of SMEs should be launched in order to identify these insidious legal irritants. These should then be systematically weaned from the world of Bangladeshi SMEs.
- (6) A small-claims court needs to be instituted, with requisite resources and mandate to match.

Appendix- 3

CRITERIA FOR SECTORAL TARGETING

The following are some of the major criteria that could be used for ranking various sector or sub-sectors in order of degree to which they were entitled to public assistance (bearing in mind that the Taskforce was severely constrained by the lack of firm data in terms of sectoral characteristics):

Strong comparative advantage: Sectors in which *factor endowments* are such as to confer strong comparative advantage compared with others qualify as a booster. Comparative advantage will be judged in terms of the sector's domestic resource cost (DRC). DRC is the ratio between what it takes, in terms of *nontradeable domestic resources*, to produce a unit of output, to the *net value added*, in *border prices*, created by the latter. Agro-processing would be one such sector.

Rising demand: Pedagogically, commodities for which *marginal budget shares* are higher than *average budget shares* are those for which demand is rising at a *higher-than-average* rate. Marginal budget shares by exceeding the average budget shares over a period of time gradually augment the latter themselves. Just as the tide is said to be raising all boats, rising demand especially calls attention to items of assistance needed to ensure that all requisite and material inputs are available on hand, so that the opportunity represented by rising demand is not lost upon the entrepreneurs in the sectors in question. Electronics and electricals and metal-using sectors come to mind as examples here, as do software development.

Backward and forward linkages: Some processing industries---agro-processing is an apt example--- can capture well forward and backward production linkages with other sectors. Examples of backward linkages

include manufacturing industries for meat conservation, machinery, and equipment, packaging materials and intermediate goods used in the processing (of meat, milk, to give just two examples). Examples of forward linkages include tanning operations, manufacture of footwear and other leather goods based on hides and skins. Light engineering come to mind as an example, as does agro-processing.

Investment in agro-processing not only adds value to agricultural commodities, but often makes them more tradable than they would be otherwise. Commercialization requires investment in processing of commodities to turn largely non-tradable rural economies into market-based economies. Improved processing of food and other farm produce can help improve the elasticity of supply of items that urbanites mostly want, and which are otherwise not always available, or are in limited supply, as urban income increases. Such improvements allow growth gains from increased exports to be converted more fully into further new employment and production, as opposed to inflation in food prices. “Consumption growth linkages” can be many times more important to growth than technical backwards production linkages (Delgado et al., 1998).

When the playing-field is not level: Markets virtually never perform as in the text-books, but are frequently skewed due to vast economic inequalities, asymmetric distribution of information, knowledge, and social-networking connections. Careful public interventions are needed so that a broad symmetry of resources can be seen to prevail.

If markets could be counted upon to deliver results that met Imperatives of good economics, period after period, there would be no need for policy interventions. Market, however, fail, and they fail often—hence public-sector interventions are needed. Sometimes, as well as *market failures*, there will be *government failures* as well to worry about.

Yet another dimension of inequality is that a complete set of markets often don't exist in some industries. For instance, insurance markets, adapted to the requirements of small-enterprise products, are often not available. Markets for knowledge-enhancing, *knowledge-let*, products are nascent or non-existent completely.

And yet, while small enterprises have to adjust as best they can for a less-than-complete range of markets, large firms can avail of their access to the control-panels of governance in order to conjure up “by-passes” that suit them.

The Taskforce has a responsibility to identify industries in which such *market failures* are to be found.

At times, there will be *government failures* as well, to worry about. This happens when various government policies work at cross purposes, aggravating, on net basis, the *market failures* they were supposed, in the first place, to eradicate, or at any rate, to mitigate.

The returns to scale are sometimes increasing

Returns to scale are said to be increasing, when *monetary economies* are reaped as the scale of output ramps up. This is *a necessary condition* for increasing concentration of ownership in any industry. When technologies are such that they kick-in *increasing returns to scale*, public interventions are usually called for so as to prevent growing concentration of market power.

The need for structural transformation is not transparent to the uninitiated

The technology shelf---the inputs, and how they can best be combined---and the demand-mix are not *static* but is evolving fairly continuously. This forces on markets the responsibility of signaling the *need* and, more difficult, the *nature* of structural transformation that can *facilitate* survival.

For example, rising incomes, growing middle-class consumerism, and demonstration-effects-in-consumption translate into an output-mix weighted towards *durable consumption* items. For the same reason, there is a

growing shift towards designer or branded items in personal consumption. Innovative, trendy design and “fashion” content are the key to success in this very fluid *niche* space: both put a premium on *knowledge* and continuous *technical innovation*. For small enterprises, to take advantage of this shift puts a premium on *foresight and innovation*. Information and sure grasp of knowledge as to how to make the transition is the challenge: such things call for *custom-built structures* of public delivery mechanism, as markets don’t exist for these inputs or resources.

Again, these days, *knowledge coefficient* in all manners of production is growing: the international division of labor is also reflecting this fact.

Strong imperatives to or compulsions for *structural transformation or structural change*---which necessitate compensating variation in *stakeholder behavior or conduct or responses*---provide a rationale for public interventions.

Structure of incentives: manufacturing vs. trading

In globalization, the formidable market power of global brands result in a structure of economic and financial incentives in the market place that is inimical to the domestic manufacturer versus the importer. It is arguable that a similar shift in the business *mindset* is enveloping Bangladesh: trading is a safer, smarter, richer and bulkier business than domestic manufacturing is. Managing workforces is nightmarishly difficult, as technical workers are exceedingly foot-loose, and manually-skilled workers are fractious. Manufacturing requires a much greater presence on the ground, and visibility invites extortion in the semi-anarchic conditions in Bangladesh. The Taskforce members heard this refrain again and again during its deliberations. Globalization and liberalization were often likened in these deliberations to exceedingly sharp, surgical knives: they can save precious lives only if they are wielded by *highly-specialized and –experienced surgeons*. The probability of unsuccessful invasion is quite high. Besides, as Pradhan and others have shown, successful globalization requires more than merely significant liberalization: it also requires large and

growing investment in infrastructure, financial intermediation, education, and country branding ---all if-fy prerequisites in resource-poor and debt-dependent Bangladesh.

It is really moot if some of the *failures* cited in the foregoing are about to kick-off *comparative de-industrialization* in Bangladesh of a kind that will hurt SMEs.

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**Report of the
National Taskforce on Development of Small & Medium Enterprises (SMEs)**

August 2004

Ministry of Industries

Government of the People's Republic of Bangladesh

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Bibliography

LIST OF ACRONYMS

AEC	Atomic Energy Commission
AP	Advisory Panel

BCSIR	Bangladesh Council of Scientific & Industrial Research
BEI	Bangladesh Enterprise Institute
BER	Bureau of Economic Research
BIM	Bangladesh Institute of Management
BSCIC	Bangladesh Small and Cottage Industries Corporation
BSTI	Bangladesh Standards and Testing Institute
BITAC	Bangladesh Industrial Technical Assistance Centre
DFI	Direct Foreign Investment
DRC	Domestic Resource Cost
SME	Small and Medium Enterprise
OECD	Organization of Economic Cooperation and Development
GNP	Gross National Product
HS	Harmonised System
ICT	Information and Communications Technology
ICG	International Consulting Group
IP	Internet Protocol
ITES	Information Technology Enabled Services
LGRD	Local Government & Rural Development
LTI	Leather Training Institute
MES	Minimum Efficient Scale
MOI	Ministry of Industries
NASCIB	National Association of Small Cottage Industries in Bangladesh

NBR	National Board of Revenue
PCB	Printed Circuit Boards
POS	Point of Sale
QA	Quality-Assurance
QC	Quality Control
R & D	Research & Development
SCITI	Small & Cottage Industries Training Institute
SIDBI	Small Industries Development Bank of India
UNESCAP	United Nations Economic & Social Commission for Asia & Pacific
UPS	Un-interrupted Power Supply
VAT	Value Added Tax
WTO	World Trade Organization

A précis of Taskforce Recommendations

The National Taskforce on SME Development has organized its recommendations in three groups in order of their underlying time-horizons: short, medium and long-term.

SHORT-TERM RECOMMENDATIONS

10. Role of the Government:

The primary role of the Government should be that of a facilitator to aid naturally growing SME's through removing market and policy obstacles, and secondly providing necessary promotional support.

11. Policy Statement:

The Government make an unequivocal declaration of commitment towards development of Micro and SME's as the vehicles for quality of life improvement, economic growth and poverty alleviation of the common people.

12. SME Advisory Panel:

In the short term (the first eighteen months following implementation), until the SMEF can be established, an SME Advisory Panel be constituted involving experienced committed specialists and entrepreneurs of relevance to work together with the SME cell of the Ministry of Industries (MOI). The present SME Taskforce will continue to monitor the implementation of its recommendations.

13. SME Foundation:

An SME Foundation (SMEF) be established to carry forward the cause of SME's in the country. This will be a body with a sovereign charter, with government and especially donor-agency funding. This will be constituted involving experienced committed specialists under the monitoring of a governing body with representations from the funding authorities, SME Associations, and Civil Society experts.

14. Tactical Plan of Action:

A **roadmap** and a **tactical plan of action**, may be conceived and then detailed by **SME Advisory Panel** and the **SME Cell**.

15. Definition:

Enterprises be categorized using the following definition (fixed investment implies exclusion of land and building, and valuation on the basis of current replacement cost only):

- a. Small Manufacturing Enterprise: Fixed investment less than Tk.15 million.

- b. Medium Manufacturing Enterprise: Fixed investment greater than Tk.15 million but less than Tk.100 million.
- c. Small Non-manufacturing Enterprise: Less than 25 full time employees.
- d. Medium Non-manufacturing Enterprise: Less than 100 full time employees.

16. Booster Sectors:

For promotional support the following 11 booster sectors be identified:

- a. Electronics and Electrical
- b. Software Development
- c. Light Engineering
- d. Agro-processing and related business
- e. Leather and Leather goods
- f. Knitwear and Ready Made Garments
- g. Plastics and other synthetics
- h. Healthcare and Diagnostics
- i. Educational Services
- j. Pharmaceuticals/ Cosmetics/ Toiletries
- k. Fashion-rich personal effects, wear and consumption goods

The list of booster sector should be reviewed every three years

17. Preferential Criteria:

- a. A preferential criteria be set for evaluating entrepreneurs
 - 18.** Successful track record as an entrepreneur.
 - 19.** Membership in traditional entrepreneurial groups.
 - 20.** Above average insider equity participation.

21. Professional specialisation of top management in relevant production skills.
 22. Certification from globally recognised quality assurance (ISO 9001 etc.)
 23. High management capability and commitment to innovation (Technopreneur)
- b. A preferential criteria be set based on the size of an enterprise – smallest getting the top priority.
- c. Women entrepreneurs be given preference in conjunction with the above criteria.
- 24. VAT exemptions:**
- a. For Manufacturing SME's not under foreign joint venture, the following VAT exemptions be made (fixed investment implies exclusion of land and building):
 - a. Total exemption if fixed investment is less than Tk.3 million.
 - b. 2.5% turnover tax if fixed investment is above Tk.3 million but under Tk.15 million.
 - b. VAT on a product at local production point cannot exceed that on the import of similar finished product. If the latter is changed at any time, the above condition be applied automatically.
- 25. Tax Holiday:**
- Tax Holiday be given only to manufacturing enterprises with fixed investment under Tk.3 million, 7 years within Dhaka and Chittagong cities and 10 years at other places.
- 26. Tax-rate:**
- Total incidence of all tax-rates at import on raw materials cannot exceed 60% of that on finished imported products. If the latter is changed at any time, the above condition be applied automatically.
- 27. Credit Distribution:**
- a. At least 80% of the total resources available be allocated to small enterprises, medium enterprises to get from the rest.
 - b. Initially Basic Bank be chosen as the lead bank to disburse the project funds, later SMEF itself taking up the responsibility.

- c. 10% of the available resources be made into a Venture Capital fund to promote technologically challenging but viable innovative products, preferably given to Technopreneurs (technical product innovators turning entrepreneurs). The SME Advisory Panel/SME Foundation may be made responsible for its disbursement.

28. Quality Certification:

- a. For Quality Certification to products, BSTI be reorganised with representations from the appropriate SME's, civil society expert bodies or individuals in its governance.
- b. SME Associations be encouraged, side by side, to organise their own Quality Assurance certifications, and be provided partial monetary support for setting up modern QC laboratories.

29. Methodical survey:

A very methodical survey, supported by a preferably two-stage stratified random sampling, of the SME's be taken up immediately involving the above partners. This may be followed by a full census of all SMEs at an appropriate later time, and repeat surveys be made every three years.

MEDIUM-TERM RECOMMENDATIONS

30. Evaluation Mechanism:

For project support a two stage evaluation mechanism be followed – first one on entrepreneurial quality, second one on the project itself.

31. SME Web-portal:

An SME Web-portal / Virtual Front Office covering all possible requirements of SME development be set up under the SME cell / SME Foundation.

32. Claims Court:

A Small Claims Court be instituted to cater to particular issues of SME's.

33. Human Resource Development:

- a. Human Resource Development programmes be taken up to improve both entrepreneurial and worker skills under SME Cell /SME Foundation in collaboration with existing facility providers like BSCIC-SCITI, BIM , BITAC, etc.
- b. An R&D fund be generated for financing SME product and process development research.
- c. International technology-exchange programmes be set up to boost SME's in Bangladesh.
- d. Public and private R&D organisations (BCSIR, AEC, Universities, Polytechnics, etc.) be oriented to R&D for product and process requirement of SME's.

LONG-TERM RECOMMENDATIONS

34. Curriculum of educational institutions:

1. Curriculum of educational institutions, particularly those of Engineering Universities & Colleges, Polytechnics and Vocational institutes be revised to make them SME development friendly.
2. Number of Polytechnic Institutes be increased to increase the number of possible entrepreneurs.
3. Science and Technology graduates be prepared and trained in technologies that may have an direct impact on the quality of life of our common people in the coming years.
4. The recommendations be categorised into appropriate timeframes – short term, medium term and long term – for realistic implementation goals, as given in the body of this report.
5. Clusters in inner-cities be promoted.

EXECUTIVE SUMMARY

2.0 Introduction

Small and Medium Enterprises (SMEs) have historically been one staple of the enterprise landscape within economies globally. Especially growth with clear benefits for poverty reduction puts a premium on integrating, productively and profitably, small and medium enterprises in the very process of economic growth. The over-riding vision must be for setting up a market-based economic order with a level playing field for all enterprises, in which SMEs can aspire to opportunities of growth and wealth-creation commensurate with their own endowments and diligence, innovation and management commitment. In addition, the vision must lead to a priority in the delivery of government services so as to neutralize, on a continuing basis, the handicaps and irritants which, almost reflexively, tend to spring themselves upon SMEs in a selective manner. A historically accelerated pace of trade liberalization in Bangladesh since the early 1990s by spurring a veritable deluge of imports has quite significantly increased competitive pressures on SMEs in Bangladesh. Rapidly falling cost of communications have by unifying global markets heightened the intensity of competition. Trading is widely seen as a safer, richer, smarter and bulkier career to have than manufacturing---bad news indeed for industrialization. It is against this background that the Government of Bangladesh constituted the Taskforce on Small & Medium Scale Industries late in 2003. This report is the harvest of the effort of the Taskforce.

2.0 Objectives of the Taskforce

In essence, the Taskforce's cardinal objectives are the following:

To draw up a realistic strategy, which reflects current operating characteristics and binding constraints, for promoting rapid growth and vigorous competitiveness among SMEs in Bangladesh in the interest of accelerating the growth of the economy and reduction of poverty in the country;

To formulate a framework of policy formation to achieve development of SMEs, as also a broad *plan of actions*, just shy of a more detailed suite of specific action programmes with corresponding actors and time-lines to match;

To recommend a set of SME-development policy for Bangladesh, categorized in terms of the three time-frames of short-, medium- and long-term;

To redefine the small and medium enterprises---both of manufacturing and non-manufacturing types--for the purposes of the practice of SME development policies. At the same time, to formulate criteria of enterprise eligibility to the assistance package.

To prescribe, on some well-agreed rational bases, a number of *booster* industries with a sizeable proportion of SMEs which then to create a package, comprising at once of major financial-assistance, fiscal rationalization and some capacity-building programmes for. Wherever appropriate, priority will be accorded to entrepreneurs from *social categories* that have been crowded out during liberalization (such as *tantees, telli, sonar, etc*), small enterprises and entrepreneurial activities by women;

To produce a self-contained set of implementation guidelines for the Taskforce's prescriptions to have lasting value, recognizing that guidelines are not the same thing as specific implementation execution;

In view of the rapid structural change in the world economy, especially in favor of increasingly weightless, paperless, knowledge-rich *industries and services*, to see structural change as among major imperatives for intervention by government and the civil society that are supposed to have an advantage on informed strategic planning that private investors probably lack.

Proven or demonstrable *market failures* or *policy failures*, *the playing field being uneven*, or *increasing returns to scale* or *imperatives for structural transformation* were accepted as important rationale for public intervention. The Taskforce adopted an SME-only approach towards the capture of priority actions to impact *selectively* upon the competitive handicaps of the SMEs.

3.0 Taskforce's major findings

- 3.1 Development of SMEs is increasingly being held at the highest echelons of policy-making globally, as a permanent and integral part of poverty-reduction strategy of the governments of developing countries. Success here will require acting decisively in terms of making SMEs' scarce financial resources go further, and harnessing, up to the hilt, human resource and institutional capacities of the stakeholders in SME development.
- 3.2 Artisanal manufacturers, often closely associated not only with several occupational categories, such as *tantees, tellis, sonars, kumors, kamars*, etc., but also with traditional technologies competitively pressurized by modernization, impacted moreover upon by various policies, have been crowded out during that process. At the same time, many promising entrepreneurs have sought, innovatively and diligently, commercial viability, but have, for all their efforts, found the effort to be a mostly losing battle, due to others' prejudices, uneven playing-field and mostly inconducive policies. A continuing effort to mainstream these increasingly marginalized entrepreneurs into the very fabric of healthy industrialization is a major imperative before Bangladesh's SME development.
- 3.3 With liberalisation apace, withering competition from more entrenched countries and globally-branded companies operating on a global scale, and with deviations from the *rule of cascading* in the setting of border tariffs, trading has become a career of choice in Bangladesh at the expense of manufacturing for many who would have otherwise worn happily the mantle of a manufacturer.
- 3.4 There are systematic handicaps which choke the SMEs' entrepreneurial drive or put a crimp on their choices, and thus drag their net performance, *versus* their competitors'---thus justifying prescriptions which selectively impact SMEs in an effort to alleviate, if not remove altogether, such handicaps.

- 3.5 In an age of sweeping globalization, and growing penetration of information and knowledge technologies into the emerging international division of labor, appropriately positioning Bangladesh's SMEs in the resulting structural transformation of the global economy is seen as an important basis for both selecting the booster industries as well as the enterprises deserving injection of public assistance that benefit them.
- 3.6 While governments often perform poorly in production, they have (or at any rate can potentially acquire at low cost) an innate advantage in terms of acquisition, dissemination and maintenance of a base of information and knowledge of a kind that enhances productivity of private investors' business decisions in an inclusive manner. In addition, governments by virtue of its vastly superior catalytic or mobilizational potential have ameliorative role(s) to play when either markets fail, or externalities skew private investors response in sub-optimal ways or when venture-capital is in too short a supply for the nation's good in high-risk-high-gain investment opportunities. In such cases, there is a well-grounded rationale for public intervention, including as a provider of equity capital, a practice in which a modest beginning has already been made in Bangladesh.
- 3.7 There has not recently been even a single survey or authoritative analyses of operational characteristics and binding gaps and failures (market and government failures) relating to SMEs in Bangladesh. The knowledge base for efficacious policy-formulation for SME development in Bangladesh is very poor.

4.0 Lessons from international experience

The Taskforce has been benefited from the assimilation of several major lessons from recently-concluded Ministerial Conference on SME Development in Istanbul, held under the aegis of the Organization of Economic Cooperation and Development (OECD). Several of these lessons were also independently emphasized in the deliberations in meetings of the full Taskforce, as also of its Drafting Sub-Committee. Several of the most important lessons are as follows:

- 4.1 Because a considerable extent of strategic stewardship and gap- filling---with the gaps in question not being visible to the private decision-makers--- is typically required in this kind of structural transformation, a three-way set-up, involving the government, including local government, civil society and the private sector, is typically required. Only the government can be entrusted the central role of the architect of the change management, with the provision that it will formulate a broad plan of actions and then a much more detailed action programme for execution. Government and civil society institutions in question typically also need technical assistance and capacity building so as to attain maximum cost-effectiveness. That is why such improvement in the competitiveness of SMEs *versus* large enterprises typically requires a modification of the structure of public investment in desired directions. The policy and institutional-delivery set created for the development and empowering of the SMEs should be promotional, catalytic, incubatory and selective, and should not involve indiscriminate subsidies. To the extent that removal of specific market failure or previous government failure or negative pecuniary externality puts a premium on the creation of a package of financial incentives, then perhaps small subsidies may also be justified, especially if they can be well-targeted.
- 4.2 There is precedent in Asia of well-directed government intervention in a coherent package of ameliorative and stimulative action, including of channelizing strategically-focussed and small dose of financial subsidies, in the interest of fostering the growth of SMEs. Perhaps, a similar case can be made for SME development in Bangladesh, too.
- 4.3 It is important to foster the evolution of a congenial, transparent and simplified *regulatory* framework that keeps low the compliance costs of an enabling environment for SMEs, and especially small enterprises. By avoiding invasive procedures (such as rent-seeking behavior, etc) and keeping cost of compliance low, many countries have integrated informal-sector enterprises in mainstream SME development.

5. Elements of SME policy

- 5.1 The elements of SME policy that have framed our deliberations require that the Government of Bangladesh:
- (i) Accept SMEs as an indispensable player in growth acceleration and poverty reduction, worthy of its total commitment in the requisite overall policy formulation and execution;
 - (ii) Identify and establish the network of infrastructure and institutional delivery mechanisms that facilitate the promotion of SMEs;
 - (iii) Re-orient the existing fiscal and regulatory framework and government support institutions towards bolstering the goals of SME policy;
 - (iv) Nurture and partner civil-society institution(s) having credible management teams in terms of the delivery of needed services, leadership, initiation, counseling, mentoring and tutoring; etc.
- 5.2 Create innovative but meritocratic arrangements so that deserving and especially small enterprises with desired entrepreneurial antecedents and promise can be offered financial incentives within industries prescribed on some well-agreed bases.
- 5.3 Help implement dispute settlement procedures that proactively shield small enterprises especially from high legal costs and insidious harassment.
- 5.4 Take measures to create avenues of mobilizing debt without collaterals to match (either using *debt-guarantee schemes* or mapping *intellectual-property* capital into *pseudo-venture capital*) in order to assist small enterprises in dealing with their pervasive lack of access to finance.
- 5.5 Accord, systematically, precedence to small *versus* medium enterprises, within the limitations of government's resources.

5.6 Harness information & communications technologies, Internet Protocol (IP)-based infrastructure, and electronic-governance in an effort to parlay regulatory services, all kinds of useful information and mentoring inputs, with an accent on increasing the viability of SMEs in all sectors of the economy.

6.0 TASKFORCE'S RECOMMENDATIONS

6.1 Identification of *booster* Sectors

The following industries, including one based exclusively on the imperative to foster women entrepreneurship, are prescribed by the Taskforce for *preference* in terms of prospective public assistance and capacity-building programmes, within the limitation of a review every three years:

Electronics and electrical;

Software-development;
Light engineering and metal-working;
Agro-processing/agri-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;
Pharmaceuticals/cosmetics/toiletries;
Fashion-rich personal effects, wear and consumption goods

Notwithstanding the prescriptive nature of the foregoing recommendation, non-classification as such should not disqualify an SME from financial assistance from any scheduled banks.

6.2 Policy recommendations

The Taskforce has organized its recommendations in three groups in order of their underlying time-horizons: short-, medium- and long-term.

- a. By short term, we mean actions whose impact may be felt between now and 18 months away.
- b. By medium term, we mean actions whose initiation could take up to 18 months, whose fruition could well take between 18 month and 4 years.
- c. Long-term is defined as something that takes more than 4 years to fructify.

6.3 SHORT-TERM POLICIES

6.3.1 Framing and carrying out policies for SME development

- a. **Policy statement:** The Government shall make an unambiguous policy statement declaring that the Government consider SMEs, especially small enterprises, as an integral and important element in the cause of economic growth and poverty alleviation in Bangladesh. The current Taskforce will continue to monitor the implementation in future of its recommendations.

- b. **SME Advisory Panel:** An SME Advisory Panel (AP) shall be constituted to perform the services of a *specialist brains-trust* for the Ministry of Industries (MOI). The Panel will report to the Minister of Industries. The first task of the AP would be to author a tactical plan of action about what it will take to move SMEs forward the way they should. A SME Cell shall also be set up in MOI to help implement the SME policies.

The Panel may comprise a few of the members of this Taskforce, appropriate civil-society institution(s), subject-matter specialists, industry association(s) associated with SMEs, role models with a track record for generating mass interest in technopreneurial careers.

- c. **Tactical Plan of Action:** A **roadmap** and a **tactical plan of action**, may be conceived and then detailed by **SME Advisory Panel** and the **SME Cell**.

- d. **SME Foundation:** In the medium term, the Advisory Panel and the SME Cell will eventually morph into what we call a **SME Foundation**. It is the SME Foundation which will become the bedrock for all major

dimensions of SME development (this is further detailed under the rubric of medium-term recommendations of the Taskforce).

6.3.2 Definition/Identification of SMEs

Defining enterprises for targeting purposes in terms of either fixed investment or head-count is a well-established policy practice, for instance in South Asia region. A one-attribute definition typically reduces the proportion of *indeterminate* cases compared with a two-attribute one. Any definition, no matter how well-thought-through is bound to involve some degree of arbitrariness.

b. For **manufacturing** industries, the Taskforce recommends that:

- ◆ **Small enterprise:** an enterprise should be treated as *small* if, in today's 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 be up to Tk. 15 million;
- ◆ **Medium enterprise:** an enterprise would be treated as *medium* if, in today's market prices, the replacement cost of plant, machinery, and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and building, were to be up to Tk. 100 million;

c. For **non-manufacturing** activities (such as trading or other services), the Taskforce defines:

- ◆ **Small enterprise:** an enterprise should be treated as *small* if it has less than 25 workers, in full-time equivalents;
- ◆ **Medium enterprise:** an enterprise would be treated as *medium* if it has between 25 and 100 employees;

By making the definition especially of small enterprises more inclusive with a lower threshold for assistance eligibility, the outreach of SME policy for poverty alleviation and employment generation has been augmented *versus* all past statements of industrial policies.

Proposed definition sets the threshold smallness at a much lower level compared with the treatment in the Industrial Policy of Bangladesh (1999). The Taskforce recognizes that there will remain a need for National Board of Revenue (NBR) and other implementation arms of the government to incorporate the definitions in the declared SME policy within their own operating environment.

6.3.3 Setting preferential criteria for deserving enterprises

Enterprises which, as well as meeting the size requirement proposed by the Taskforce, shall have

- a. proven credentials as an entrepreneur (for example, membership in well-recognized social occupational groupings, successful track record) with requisite presence and facilities on the ground;
- b. an above-average *insiders' equity participation*;
- c. certifiable professional specialization of top-management in relevant production skills;
- d. the stamp of approval from globally-recognized quality-assurance bodies (ISO 9001:2000, for example);
- e. High management commitment to innovation.
- f. Women entrepreneurs will be accorded preference, wherever appropriate.

- g. Other things being equal, smaller enterprises shall be given preference in terms of benefits from interventions by the government and civil society initiatives.

6.3.4 Rationalization of VAT and other budgetary measures

- a. **Exemption to Pay VAT:** We recommend that very small manufacturing enterprises with fixed investment of up to Tk. 3 million (three million) excluding land and buildings, shall be completely exempt from any obligation to pay VAT. Manufacturing enterprises with fixed investment greater than Tk. 3 million and less than Tk. 15 million, excluding land and buildings, shall pay turnover tax at the rate of 2.5% (two and a half percent).
- b. **Tax Holiday:** We recommend that such very small enterprises (with up to Tk. 3 million in fixed assets not counting land and building) should be given a tax holiday for 7 (seven) and 10 (ten) years from their initiation, for enterprises in the cities of Dhaka/Chittagong and all other areas/locations respectively. Both recommendations (a) and (b) will, we propose, be applied in **all** industries, not just the boosters.

Exceptions:

The above facilities will not be given to:

- i) Joint Venture industries with foreign partners,
- ii) Sectors that should be discouraged based on health, environment, or other grounds such as Tobacco, liquor and narcotics related industries.

d. Protect local industries: We recommend two blanket clauses to protect local industries from irrational tax policies:

- i. The total incidence of all taxes at import (Import duty, Supplementary Duty, Regulatory Duty, Development surcharge, VAT, etc.) on the raw materials and spares of locally produced commodities cannot exceed that on corresponding finished imported commodities. If such taxes for a finished

commodity are reduced at any time, then the taxes on the raw materials and spares of that product will automatically stand adjusted following the above principle.

- ii. VAT on imported products shall not be less than that on like domestic products. Any reduction in existing VAT on imported products shall be automatically matched by an equal reduction on VAT on like domestic products.

6.3.5 Credit-distribution Package and venture capital - market

- j. A credit-distribution package will need to be worked out by the Ministry of Industries. An innovative scheme---rather like a two-stage screening mechanism---that can really probe for the bone fide of the applicants as entrepreneur material will be deployed. Donor financial resources made available specifically to help with implementation of SME policy being enunciated here would only be allocated to competitively-selected enterprises within the booster industries here being prescribed.
- k. Of the total resources available, no more than 20% may be earmarked for medium enterprises, while the remainder, 80%, will be earmarked for small enterprises. Within each division, the resources will be divided up into a public-sector venture-capital fund (10%), approximately on the lines of the currently-implemented EEF at the Bangladesh Bank. The remainder will be allocated to a *credit fund*. (This does not have anything to do with debt-equity ratio relevant in discussions of enterprise financing.)
- l. In the short run, the distribution of the credit fund and venture-capital fund will be the task of the BASIC Bank, which is here being recommended as the lead bank, it being borne in mind that BASIC Bank will closely work with the Advisory Panel. (Over the medium term, this responsibility will devolve to the SME Foundation.)

- m. The Ministry of Industry and the SME Advisory Panel/Foundation, as the case may be, will determine modalities of how to implement both the credit-fund and the venture-capital fund.
- n. Within the oversee of the Advisory Panel, projects to be funded from the venture-capital fund will be evaluated by a team of experts which will be constituted as a part of the implementation of SME Policy.
- o. A publicly-mandated venture-capital scheme be created in deference to the rationale cited in the main text. It will also give a stimulus to the morale of entrepreneurs who commit in-house capital to projects with novel and potentially innovative processes and technologies with demonstrable potential for commercial success. Such projects have a-typically high risk and high returns. This recommendation is rationalized in terms of the private under-investment based on extensive, even potentially crippling, negative pecuniary externalities in certain among the booster industries prescribed here, with regard to the leaching of shareholder's value outward from the enterprise.
- p. The Advisory Panel working together with the Lead Bank in the short-term, and the SME Foundation in the medium- and long-term, would implement a transparent and meritocratic arrangement for steering public equity and debt resources into a genuinely deserving selection of enterprises.
- q. The development of human resources in both the BASIC Bank and the SME Foundation with regard to effective targeting of resources made available under public equity funding would remain imperative.

6.3.6 SMEs need for quality-assurance (QA) stamp-of-approval

- e. Bangladesh Standards and Testing Institute (BSTI) with its accountability to SMEs fundamentally enhanced through appropriate SME representation in its governance, and with appropriate

representation from civil society institution(s), might become the focal point for offering assistance with regards to securing quality-assurance (QA) certification from registrars of QA.

- f.* Suitable SME-related industry association(s) should be empowered to issue non-mandatory certification, albeit with high professional integrity, with regard to quality assurance. Such association(s) would be eligible to grants from Government towards the cost of setting up required testing laboratories and other facilities.

- g.* Small, out-right co-financing grants may be available for registration with globally branded QA registrars (say with ISO 9001: 2001 or equivalent).

6.3.7 Multi-stage Sample Survey of SMEs

There is an urgent need for a major overhaul of the availability of reliable and current *data* about the characteristics of SMEs. The Taskforce recommends that the Ministry of Industries immediately take up the conception and implementation of a multi-stage sample survey of SMEs in the metros and the district headquarters. Ideally, there should be a complete enumeration of all SMEs, the data from which should be of use in drawing up a survey methodology for a systematic stratified random sampling.

6.4 MEDIUM-TERM POLICIES

The OECD have recently opined that one of the major challenges of transitional and developing countries in this age of sweeping globalization is to ensure rapid development of the SME sector by harnessing scarce human and institutional capacities in availing of trading and investment opportunities. In consonance with this imperative, the Taskforce puts forward a package of medium-term recommendations.

6.4.1 Formation of a Small and Medium Enterprises Foundation

- b. Over the medium term and beyond, the Government **must** remove all remaining obstacles impeding the formation of an SME Foundation as a pivotal platform for the delivery of all planning, developmental, financing, awareness-raising, evaluation and advocacy services in the name of all SME development as a crucially-important element of poverty alleviation.
- c. The Foundation would, it is recommended, strive to provision one-window delivery of all legal, administrative and regulatory facilities, including some resources needed for capacity-building in appropriate industry association(s), for SMEs in Bangladesh.

6.4.2 A Tactical Plan of Action

- a. **Strategic skills upgrading:** The tactical plan is needed to move from gap analyses to skills upgrading based on the product(s) in the booster-sectors identified in this report, paying careful attention to the requirements of the production clusters in the inner cities (such as Dholai Khal, Mirpur, and the like).
- b. **Enabling environment:** An enabling environment in which both extant and aspiring entrepreneurs find within an easy reach most of what they direly need---information, counseling, mentoring, access to finance, technology and the means to market.
- c. **Supply chain for technopreneurship:** A serious effort is recommended for fostering a *supply chain* for *technopreneurship*. Bangladesh needs role models that can get intelligent and diligent people excited about creating value through successful entrepreneurship. It is recommended that the SME Panel/Cell

and the SME Foundation conceive programs in popular media, and anchor(s) for them to match, modeled after some widely-accepted success stories.

- d. **SME Web Portal:** An online-community, availing of relevant information and communication technologies, of both extant and aspiring SME entrepreneurs, to be hosted on a SME Web portal in the SME Cell/SME Foundation, for the divining of technology, product and market trends, for career-counseling to benefit science/technology graduates, for technopreneurial problem-solving session(s), for mentoring using *guru-disciple symbiosis*. (*The Taskforce is fully aware that pulling off such innovation would require careful planning and nearly flawless execution*).
- e. **Towards a virtual SME front-office:** A Web-based virtual *front-office* providing all start-up assistance to SME entrepreneurs (application forms, FAQs, limited directory-assistance, success stories, horror stories, etc): an *one-stop-service*, with all interactions between the user and the system stored on databases in the interest of providing institutional memory.
- f. **Exports-friendly content on the SME portal:** Information regarding standards of labor and output pertaining to overseas markets to benefit export-oriented SMEs should be put on the Web portal.
- g. **Electronic-governance with a human touch:** Such structures of electronic-governance should be supplemented, at least for a time, by human touch, with adequate budget to match, to physically attend to the needs of small entrepreneurs who take recourse to them. This is based on the recognition that a totally hands-off delivery of all requisite services to SMEs is an ideal whose achievement was likely to only happen in stages.
- h. **High-performance communications backbone:** A high-performance fiber-optics communications backbone be put in place *in six* of the country's largest metro-markets (namely, Dhaka, Chittagong, Rajshahi, Khulna, Sylhet and Barisal) so that the launch of some serious ICT-centric applications to

benefit e-governance to the profit of SME development is not unduly handicapped by woefully inadequate bandwidth.

- i. **International technology-exchange programmes:** Technology-exchange programmes between countries with similar stages of development, and with a similar maturity of the infrastructural development for SME development, in the interest of rapid technology transfer.

6.4.3 Formulation of a package of capacity-building and training

- a. **Specialized professional expertise:** Specialized professional expertise in carefully-chosen niches that the Panel of Advisors recommends has potential for a broad-based replication. Such training can be so packaged to such high standards that the recipients feel motivated to pay up *user charges*, however minimal.
- b. **Re-skilling boot camps:** Re-skilling *boot camps* would need to be organized for each of the booster industries by rotation, with a view to provide periodic technology grounding in efficacious skills among workers in SMEs.
- c. **Institutional capacity for training:** BSCIC/SCITI, BIM, and BITAC---where a lot of equipment, infrastructure and other resources are in place---should undergo a significant strategic *reorientation of their own core competencies* under the watchful eye of the Advisory Panel/SME Cell. In particular, the skills and competencies needed to enable SME hold their own in the booster-industries in the changed global business environment should be re-emphasized in the ensuing revamping of these institutions.
- d. **Capacity for coordination among multiple institutions:** Several public institutions (such as Atomic Energy Commission (AEC), Bangladesh Council of Scientific Investigation & Research (BCSIR), Leather

Training Institute (LTI), the Textile colleges, the Ceramics Research Institute, the public universities, etc) have significant capacity for both product- and process-innovation of real value for SME development. The case for harnessing all that productive capacity in a coherent and harmonious manner can be over-emphasized. However, achieving this will require a great deal of institutional coordination among various Ministries of the government.

- e. Technical assistance and investment:** Towards this end (as stated above), technical assistance and investment are both urgently needed to appropriately accent the training and motivational in these institutions so that they can become durable fixtures of technical and managerial skills can be nurtured, in a format of public-private partnership.
- f. Private-public collaboration:** The selection of such training courses and then the delivery of such training is an important instance of *public-private collaboration*.
- g. R & D with potentially high-impact profiles:** R & D that lead to prototypes with a scope for replication in potentially high-impact product *niches* (eg in the field of mobile games, 3-D animation, or bio-optics, or the manufacture of computer-controlled industrial and medical appliances, or spurring the use of resin in new production applications, etc);
- h. Curriculum development for vocational training:** Curriculum of vocational training institutes be revised and reviewed to make it SME development friendly.

6.4.4 Evolving of an SME Eco-system

Two kinds of institutions are recommended, preferably for adoption by civil society role models/ catalysts, bearing in mind that these institutions will not be in the employ of the government.

- e. The mission of the first kind is in trying to render stakeholders out of indigenous young science and technology graduates by bringing to their agenda for poverty alleviation the currently-missing *fulcrum* of technological innovations to improve the quality of life of the poor in Bangladesh.
- f. The mission of the second is to achieve mastery over a rapidly-changing slate of IT skills, and to then quickly disseminate them among young self-starters, including in the university/polytechnic/colleges' stream, through a regime of online and "brick-and-mortar" interactions.
- g. Efforts to accelerate the retention and promotion of women entrepreneurs should be strengthened.
- h. Greater stakeholder involvement in the entire gamut of activities by way of SME development while maximizing the extent of ownership to be promoted.

6.4.5 Mitigating Impediments in clusters

One should make an effort to identify three or four promising *lines of production* in a handful of clusters in the metros of Dhaka and Chittagong, where small enterprises abound. Gap analyses that lead to the diagnoses of weaknesses that stymie their productivity should then be launched. Several *technical assistance studies* should then be aimed at these problems.

6.5 LONG-TERM POLICIES

6.5.1 Education and Generational Ethos

- g. Bangladesh should increase the number, and enhance the quality of technical education in, the country's *polytechnic institutes* in the interest of increasing the number of entrepreneurs.

- h. Content of a kind that seed, early on in the global-view of the children, the attractiveness of entrepreneurial careers should be pressed into service.
- i. Similarly, the accent on mathematics, science and technology fare should be made stronger in the educational curricula of schools and colleges in Bangladesh.
- j. A census of all small and medium enterprises in Bangladesh should be conducted. This is likely to require a very large investment.
- k. The legal and contractual framework prevailing in Bangladesh often increases especially small enterprises' handicaps. A survey of SMEs should be launched in order to identify these insidious legal irritants. These should then be systematically weaned from the world of Bangladeshi SMEs.
- l. A small-claims court needs to be instituted, with requisite resources and mandate to match.

Chapter I

INTRODUCTION

1.0 Importance of SMEs

1.1 Small and Medium Enterprises (SMEs) are the dominant form of business organization in all countries, typically accounting for over 95% of the business population. OECD recognized that SMEs constitute an

important dynamic element in all economies as they drive innovation, especially in knowledge-based industries; and play a key role in driving sustainable economic growth, employment creation and poverty reduction, especially in developing countries. It also contributes to the social, cultural and environmental capital of nations.

1.2 In view of the rapid structural change in the world economy, especially in favor of increasingly weightless, paperless, knowledge-rich *industries and services*, to see structural change and remaining relevant as major imperatives for intervention by government and the civil society.

1.3 Acknowledging the importance of SMEs and entrepreneurship, the Government of Bangladesh reaffirming their commitment takes initiative to design a SME policies and strategies for its coherent growth. The Government of Bangladesh has constituted a National Taskforce on SME Development as Dr. Kamal Uddin Siddiqui, Principal Secretary to the Prime Minister as its chairman on 2003. (Annexure-1).

2.0 Terms of Reference of the Taskforce

In essence, the Taskforce's cardinal goals are the following:

To recommend to the Government a body of what can be called SME Policy in Industrialization for Bangladesh;

To redefine the criteria of eligibility to the assistance package in terms of size of the enterprises;

To identify, on some well-agreed rational bases, a number of industries with a sizeable proportion of SMEs which then to create an assistance-package for;

To produce a fairly self-contained set of implementation guidelines for the Taskforce's prescriptions to have lasting value;

3.0 National workshop on SME Development

A national workshop on *Development of SMEs in Bangladesh* was organized by the Taskforce on 20 February 2004 at LGRD Conference Hall and was represented by the prominent scholars, experts, government officials, representative of the development partners, and members of the civil society of the country. Two keynote papers were presented in the workshop: One “*Tackling Stock and Charting a Path for SMEs in Bangladesh*” by Bangladesh Enterprise Institute, and the other one “*Entrepreneurship Development for Small and Medium Enterprises*” by Bureau of Economic Research, University of Dhaka. Six groups formed in the workshop presented their findings and recommendations. The compilation of the recommendations of the workshop has been distributed to the participants of the workshop for further comments. The individual comments and recommendations were discussed in the meetings of the Taskforce and finally, a drafting committee was formed to produce a draft report of the Taskforce on SME Development.

4.0 Objectives

The key objective of the report of the SME Taskforce is to make a constructive and hopefully lasting contribution to identifying *booster sub-sectors*, and then to the leveling of the playing field for SMEs, and especially for small enterprises in these booster sub-sectors. SMEs, especially the small enterprises must be offered an *enabling environment* for routine operation and growth, unhindered by the predatoriness of stronger rivals, to name one of the most potent anti-thesis of their survival.

5.0 Efforts of the Drafting Committee

What follows is the first draft of a report of the Small and Medium Enterprises Taskforce: it includes the outputs from various companion efforts in the appendices. While borrowing selectively from those companion

output, the draft of this report has made an effort within merely a couple of week time-period to round out a theoretically self-contained, sectorally well-targeted, and articulated prescriptions for the policy-maker. The members of the drafting sub-committee are acutely aware that, while they have actively sought to give space to as many of the relevant threads of both analyses, discussions and recommendations from the companion output, they may have occasionally failed to capture *each item* that was important. The drafting sub-committee however feels that by including all of that valuable companion output in the body of the *overall report of the taskforce*, albeit in the appendices, the reader has not been denied of the fruits of that fertile labour.

6.0 Methodology and Approach

6.1 A good deal of thinking and writing have taken place, especially since this Taskforce was formed in November 2003, on how to spur the growth of SMEs in Bangladesh. The scholarly activity produced several reports, including the report produced by the Bangladesh Enterprise Institute. That report, as also some other work done by scholars on the subject of SMEs, produce many conclusions that are well-informed and valid. The Taskforce is much in the debt of the authors of those works.

6.2 Having said that, it is imperative that we make it frankly clear that we have taken the liberty, whenever appropriate, to employ a different methodology formulating the vital question(s) of real interest. More specifically, we have chosen to adopt a slightly more focused, perhaps more specific, approach to what is action-able within the admittedly limited financial and implementation resources of the government. The distinguishing feature of our methodology has been a constant concern with *externally-induced constraints that affects, or are likely to affect, SMEs only but not others*.

6.3 This “SMEs-only” global-view leads to side-tracking or totally omitting issues of a kind that affects alike both SMEs and large enterprises, for example. Given that the government is in any case likely to be starved

of financial and managerial resources, the SMEs-only vantage-point appears to us to be more appropriate, both tactically and logistically.

6.4 We take pains in pointing out throughout where some of the other esteemed contributors, by using a more general approach, have been led to propound a significantly more expansive, more diffuse and less tractable package of assistance interventions for SMEs, compared with the one that we have put forward.

6.5 Let us give an example of what we have in mind here. The BEI writes: “Second, the government should be focused on creating an enabling environment comprised of *sound macroeconomic and structural policies, good infrastructure, fair policy of competition*, and efficiently functioning institutions (italics added). Economic policies should focus on creating a transparent and accountable legal and regulatory framework, a policy to improve quality and transportation system.” These policies will, if they are effectively implemented, increase the productivity, across-the-board, for **all** sizes of enterprises. How can they *alleviate the competitive deficit of the SMEs **versus** large enterprises?* An SME-only approach leads us to a more focused set of actions, with a more direct impact-route for SMEs’ constraints, is likely to address them in a clear and quantifiable manner.

6.6 The Taskforce has availed of a methodology that blends five best-practices, namely, (a) synopsis of *first-principles* that rationalize *public intervention of any kind*; (b) summary of deliberations from an intensive day-long workshop held in February, 2004; (c) the two reports produced by the BEI and BER; (d) lessons from case-studies of *market and government failures*; (e) stakeholder interviews (consultants, BSCIC, NASCIB, some real-life entrepreneurs currently engaged in SMEs); and finally (f) distillation of international best-practice.

7.0 Scope of the Taskforce

The scope of the work of this Task Force is about small and medium-sized enterprises in manufacturing industries or in trading or service-based ventures. The SME Taskforce puts forward a well-structured

approach to the problem of identifying booster sectors, and “eligible” enterprises within them. With this, we now turn to the vision that has inspired the Taskforce.

8.0 Vision

The Taskforce believe that it was handed down a rare opportunity to make a difference, going forward, to the lot of SMEs in this country, draw up a tactical plan of action and finally a set of implementation details so as to spur small enterprises in a number of target industries. The period of the incumbency of this Taskforce has been one of thinking clearly about the vision and road-map for the development of SMEs. The vision guiding our work has included:

- h. That legitimately promoting SMEs---or, at the very least, keeping SMEs, especially the small enterprises *out-of-harm's-way* from the fierce competition powered by the large, formidably-branded, often multi-national, firms---would be widely accepted as an essential tenet of industrial policy of Bangladesh.
- i. Of the total resources available to SMEs, no more than 20% must be earmarked for the medium-sized enterprises, while the remainder, 80%, will be earmarked for small enterprises.
- j. Stake-holders of small and medium-scale enterprises shall run their business on a *level playing field* as regards the provisioning and pricing of each of the seven *make-or-break* inputs for any enterprise to compete, namely, **equity capital; debt finance; technical skills; management skills; marketing know-how; gainful information, especially updates about market prices and about technical-substitution possibilities;** and **capacity for continuous innovation.**
- k. Such stakeholders on the other hand must also be ready for any change-management that survival may dictate or agility may require; have a high degree of management commitment to success; and finally must

be willing to give to success what it takes by way of intelligent, prudent but diligent work whenever necessary.

1. There must be a minimum allocation certainly in the *development budget* for rendering *legitimate public assistance* to SMEs.

- m. That there will be an *Advisory Panel*, equipped with professional expertise, with a lateral *locus standi* within the Ministry of Industry, mining its expert knowledge, scouring the profit horizon for *the next big thing* that especially small enterprises could have a natural ability to excel in. This Panel must be funded reasonably, with regard to what it takes to carry out *rapid but knowledgeable appraisals*. Such a brain-trust will work like a *control-panel* for screening-in on an early-on basis the products that small enterprises could own to succeed. This body will be tasked to identify *thrust subsectors* to steer the focus of small enterprises. The Panel will also supervise the professional work to be done within the SME Cell, which currently exists in the Ministry of Industry.

- n. That inputs from service-organizations (technical, marketing and management know-how) will, whenever necessary, be accessibly priced and then be physically available when they are needed by SME businesses.

9.0 The drags the Taskforce faced

9.1 The Taskforce was handicapped by a paucity of statistical data evoking confidence in terms of the quantitative significance of SMEs in the national economy of Bangladesh. Comprehensive information as to the structure of industries where SMEs abound was also not available. Senior researchers from BIDS have pointed out that even data circulated by Bangladesh Small and Cottage Industries Corporation (BSCIC) regarding value added were deeply flawed. It is not just the case that necessary results were NOT to hand in

terms of essentially descriptive characteristics of small enterprises (such as size, value-added per worker, capital per worker). The paucity of data and information was even more limiting as regards more substantive policy matters. The structure of costs, the relative importance of the sourcing of the inputs by small enterprises between domestic production *versus* imports, the *ex-factory* prices for small/medium firms of *imported inputs* (which can allow the calculation of the effective rate of border taxation of imports), etc, are some of the required data of substantial importance, which were virtually not at all available.

9.2 All too often, the members of the Taskforce were feeling as if we were on a mission to *plan without facts* or wage a war without maps. We had no evidence of certifiable authenticity as to which are the industries in which SMEs *on our definition* had prospered or withered. We had no firm evidence as to why they had prospered or withered. To the extent that *casual empiricism* led us to surmise that one or the other industry had seen their SMEs do well, there was no evidence at all to probe such episodes for their underlying drivers, for example, whether they had done well due to their ample wits, or they had done well due to public largesse (of cash subsidies, for instance). There was too little even of *the data*, not to speak of *information* or *knowledge* as to what are the *quantitative laws of motions of SMEs* in Bangladesh. Even NASCIB, the supposed association of small and cottage industries in Bangladesh, could not produce *any real data* purporting to show the business character of their avowedly 6,000 members. The situation regarding data was simply untenable, and cried for an early effort to alleviate its poverty.

9.3 Absent such any credible empirical basis for our work, we were reduced to depending on secondary research done by scholars, on abstract inferences we could reasonably make based on *a priori* theory, and on the accumulated practical work experience of a number of SME practitioners, both inside the Taskforce and outside. We freely admit that such an amalgam is scarcely an effective substitute for having and using hard results from seasoned analysts or analyses. Even so, we believe that, while not of a flawless pedigree, our recommendations are on the whole realistically actionable

10.0 Structure of the Report

10.1 The report is structured as follows: The main report is broken into three chapters. Chapter II essentially makes the point that in the wake of fairly accelerated trade liberalization, and the growing ascendancy of both China and India as manufacturing powerhouses, the small and medium enterprises (SMEs) in Bangladesh are exposed to the chills of *oversized* foreign competition like never before. This chapter is about the role of SMEs in development. Chapter III defines the SMEs for purposes of policy discussion going forward, and then highlights the criteria for *sectoral targeting*. This chapter also finalizes a list of eleven *booster industries* that must become the focal point of a strategy for SME assistance in Bangladesh for the next three years. Chapter IV presents the policy and institutional recommendations of the Taskforce. This chapter also then issues forth a number of markers as to how the eligible *enterprises* are to be drilled down for. Chapter V presents the summary and conclusions of the report.

There are three appendices to the report. Appendix-1 presents the notification of the constitution of the National Taskforce on SME Development. Appendix-2 presents a detailed presentation of the *criteria for sectoral targeting*. Appendix-3 presents the recommendations of the groups that arose from the Workshop held on February 20, 2004.

Chapter II

ROLE OF SMEs IN THE NATIONAL ECONOMY

1.0 Trade Liberalization and Competitive Landscape

1.1 Bangladesh has liberalized conspicuously throughout the 1990s. As a result of this broad liberalisation, the overall orientation of trade policy in Bangladesh has altered considerably, in the process becoming significantly less protective and less biased towards import substitution activities and therefore less discriminatory against domestic exporters (and potential exporters). During the 1990s, the coverage of quantitative restrictions fell from 253 four-digit Harmonised System (HS) codes to 28, while the average tariff actually applied (based on total revenue collections) fell from 62.3 per cent to 23.0 per cent. Maximum customs duty declined from 350 per cent to 25 per cent during this period. In other words, Bangladesh has been a poster child of good, even docile, management of its trade and industrial policies.

1.2. Has this great effort yielded commensurate gains in terms of growth rates? The growth rates---of the GNP, the manufacturing value added, and trading sectors in the Bangladesh economy for four overlapping quinquennial periods beginning from 1976/77 up to 2003--- shows no evidence at all of a significant quickening of the rate of economic growth in any of the three growth indicators. Whereas, the differential between the rates of border taxation between the two period is highly significant. The clear implication is that trade liberalization is a necessary but no means sufficient condition of a significant acceleration of growth rate of any given developing country.

1.3. This is not the place for a fully-blown analysis of Bangladesh's trade and industrial policy. What we want however to do at the present time is to emphasize that with the dismantling of the protective tariff

structure, Bangladesh has become more *outward-looking* in how it sources its requirements for various products. An obvious by-product of that trend has been that *domestic manufacturing for domestic absorption* in which especially small and medium firms have a natural interest *may well have* declined. Business interest in making a quick profit from indenting and trading has been piqued, while successful domestic manufacturing has become very challenging indeed.^[4]

1.4. It is in this context that the recent policy interest in the SMEs has to be seen. In country after country, leaders have come to the conclusion that while accelerated trade liberalization is a necessary condition for creating an enabling environment for the broad-based growth of the manufacturing industries, the small and medium enterprises will require well-targeted assistance package, especially in terms of credit availability, skilling-up and mentoring on how to make most of the opportunities that an *outward-looking regime of trade and industrial policies can unleash*. This recognition has been instrumental in spawning in the recent times an urgent and sustained interest in the SMEs as building blocks of adjusting to the radically different market and policy scenarios in the post-liberalization era in Bangladesh.

1.5. It cannot, of course, be gainsaid that rapid trade liberalization has a knack for providing globally companies or globally-branded countries (such as China and India) a breakthrough for well-orchestrated penetration by their own products into debt-dependent countries in which SMEs are still in their infancy. Their capitulation is quick before the avalanche of imports of products from globally-branded competitors, at times from prices that suspiciously look *like dumping*, from countries that typically are capital-surplus. (A lot of the penetration by imports into Bangladesh by China and India in several lines of products is due to the formidable marketing clout of firms in the latter, not necessarily because the product was always of superior quality or most cost-effective.) Consequently, imports of the liberalizing countries can grow much faster than their exports ever can, given the non-price market barriers in the developed countries. In Bangladesh, imports payments have grown at a rate of 24% between 1988/89 and 2002/3, while exports have only grown at a rate of some 17% annually. The differences between those two growth rates are statistically highly significant.

1.6. While liberalization may well have created opportunities for gainful growth through trade on the demand side, such gains, going forward, must be seen as counterbalanced by formidable challenges on the supply side. First, competition has become increasingly fierce among the global and regional economies and enterprises, SMEs included. There are also many more producers competing for both existing and new markets and market segments for goods, services, finance and other wealth-creating technologies and knowledge. The competitive strength of China was notable in the above regard, even before the country became a member of World Trade Organization in December 2001. Indeed, market penetration and displacing pressures from China have been keenly felt by producers across Asia, particularly those suppliers (including SMEs) at lower stages of technology sophistication and relying on a high import content. At the same time, the fairly meteoric ascendancy of India since the turn of the century as a magnet for direct foreign investment (DFI), and the outsourcing of much design and development work from the OECD countries in industries as diverse from movie-editing to chip-design, is a sign, increasingly ominousness for competitiveness, of the present times.

1.7. Second, consumer preferences and market standards have become more sophisticated and exacting. Competitive advantage is now determined by several non-price parameters such as quality, health and safety, social equity in employment and production, and ecological compatibility of products and processes. Furthermore, market demand is constantly changing, a trend facilitated not least by the rapid advances in ICT, bio-engineering and new materials. In consequence, there are more frequent introductions of new products and processes, faster and more innovative design changes, shorter product cycles and smaller output batches, higher quality and greater mass customization, more just-in-time sourcing and greater punctuality in delivery. This is the context in which we are having to draw up a strategy for reviving the flagging SME sector in Bangladesh.

2.0 Role of SMEs in the National Economy of Bangladesh

2.1. According to UNESCAP, SMEs account for upwards of 90% of all firms in East and South-East Asia, as well as in Japan (Wattanapruttipaisha, 1999). It is also the biggest source of the region's employment,

including three-quarters of the region's employment, in particular its women and young workers. The relative share of SMEs in total output and exports is typically much smaller, close to a third, or so. In Bangladesh, large enterprises account only for a small percentage of all business enterprises. The percentage is much smaller in other than manufacturing than in manufacturing *per se*.

2.2. The manufacturing industry essentially comprises small and medium scale enterprises: by some accounts, 60% and 25%, respectively, of the workforce in manufacturing happen to be hired by small and medium enterprises. It is hardly an overstatement to say that small and medium enterprises are pretty much synonymous with manufacturing industry.

Table 1: Growth of Small-scale Industry Sector

Year	No. of Units		Employment	
	Small	Cottage	Small	Cottage
1981	24,590	321,743	322,110	855,200
1991	38,294	405,476	523,472	1,331,032
2001 (end of June)	55,916	511,621	808,959	166,724
Average Annual Growth Rate	6.4%	3.0%	7.6%	4.7%

Source: Adapted from Ahmed, 2002

2.3. The highlight of Table-1 is in the fact that the growth rate, between 1978 and 2001, of employment is somewhat higher than for the number of establishments.

Table 2 Small-scale Industries: how other-than-farming drives their structure

Industry Sub-sector	No. of Units, 1978		No. of Units, 1991	
	Number	% of Total	Number	% of Total
Rice Mills	12,242	51.00	13,482	35.21
Bakery	2,157	90.2	2,765	7.22
Flour Mills	1,315	5.42	1,718	4.45
Light Engineering Works	1,120	4.66	2,252	5.88
Printing & Publishing	995	4.14	1,775	4.64
Readymade Garments	757	3.15	2,365	6.18
Saw Mills	713	2.97	1,023	2.67
Soaps	143	0.59	351	0.92
Plastic Products	74	0.31	725	1.89
Automobile Servicing & Repairing	296	1.23	550	1.44
Total	19,822	82.6%	27,006	70.5%

Source: Ahmed, 2002

Note: The only aspect of this table that is hard to rationalize is the fact that the number of the establishments producing ready-to-wear garments should be as high as 757 as far back as 1978. As far as we know, the first ready-to-wear establishment in Bangladesh was in fact established only in 1977 or 1978. We suspect that there has been a significant over count of both the number of establishments overall, and in particular, of the number of garments establishments in 1978. If correct, this would imply that the growth rate presented in Professor Ahmed's paper of the number of establishments between 1978 and 1991 is a vast understatement.

2.4 Table-2 shows, on the other hand, is about what drives at least the numerical structure of the SSI with regard to the *composition of input and output*: in other words, with regard to structural change. Accepting at face value the numbers presented in that table, the proportion of establishments with their roots in agro-processing is seen to fall sharply during the period in question: from 65% to almost 46%. This is a change worth bearing in mind.

3.0 Role of SMEs in the export economy

3.1 A sector can contribute to export receipts in two ways, namely, (a) directly; and (b) through the production of intermediates, processed and semi-processed goods. How important are Bangladesh's SMEs in terms of their contribution to the exports receipts of the country?

3.2 No credible information was available to the Taskforce to answer this question convincingly. There is however a lot of stylized evidence for other economies that suggest that SMEs are the mainstay for employment and work opportunities within Asian countries. In India, for example, SMEs account for some 80% of all enterprises, whether registered or not: they account for some 35% of the production of exportable goods of that country. In some of the most export-oriented sectors, such as ready-to-wear apparels, the percentage of the country's exports from SMEs could reach pretty high figures (Box-1).

Box-1: SMEs in India's export effort

SHAF

Percentage share of SMEs in India's exports, 1998/99

Ready-to-wear garments	42.6
Basic chemicals, pharmaceutical and cosmetics	11.0
Processed foods	12.4
Engineering goods	8.6
Finished leather	8.2

Source: Mukherjee, 2002

3.3 Corresponding data are not really available for Bangladesh. Our own guesstimate is that for ready-to-wear garments and processed foods, the corresponding percentages would be close to 50-60%, and 65%, respectively. While more numerous data are not available, it will suffice for present purposes to say that SMEs in Bangladesh are also the very backbone of its economy to generate work opportunities especially for young people and females workers who want to work.

4.0 The Study by the International Consulting Group (ICG)

4.1 The only recent study which the Taskforce was able to lay its hands on is the draft report by Daniels (2003). There is no doubt that this is an important effort, as it analyzes data from 10096 enterprises

throughout Bangladesh. The findings presented in this report are, however, less than usable for the report of the Taskforce: Daniels aggregates micro, small and medium sized enterprise into one *catch-all* category. While one has a composite category that is the direct obverse of “large” enterprises, it does not come to be very handy in the case of an analysis, as in this particular case, concerned with small and medium enterprises. Ideally, we would have liked to have the results where the “micro” enterprises have been screened out.⁵

4.2 Nonetheless, the following two tables from Daniel’s work appear to throw some light on what we have been trying to say in this report. The first of the table shows net profit earned by the sample enterprises, the latter being arrayed in order of their size (measured by the head-count). The result that leaps off the page is about an inverse association between *size* and *net profit per worker*: the large the enterprise, the less profitable it becomes. It is even correct to say that single-workers enterprises are the most profitable.

Table 3: Median net profits per worker per year by gender of owner and sector				
	Female Owners		Male Owners	
	Actual hours (Taka/work/year)	Full - time Equivalent (Taka/work/year)	Actual hours (Taka/work/year)	Full - time Equivalent (Taka/work/year)
Agriculture	6,800	10.014	8,917	11,118
Fishing			17,583	19,265

Manufacturing	6,908	8,350	19,796	13,657
Construction			21,000	19,220
Wholesale & retail trade and repairs	10,445	6,922	23,742	13,567
Hotels & restaurants	4,646	-567	17,793	6,794
Transport, storage & communication	13,475	4,197	31,938	18,104
Real estate, renting & business activities	13,788	13,293	19,850	12,219
Education			16,436	9,042
Health and social work	12,825	18,692	21,547	19,560
Other service activities	19,370	12,870	27,013	14,671
Overall Average	6,943	7,344	19,000	13,102

Source: (Daniel, 2003)

4.3 Daniel’s report as yet does not produce any cross-tabulation of *net profit results* in terms of both size and production of sector of origin, simultaneously. One could then delve a little deeper into these results. Daniel’s report also does not present any estimate as to the *capacity utilization* achieved by the various enterprises in the various situation. Absent such supporting analyses, it is not really possible to take our understanding very much farther than the fairly limited resolution of the issues that are really staring this Taskforce in the face.

4.4 This is one reason why the Taskforce believes it will be in the interest of SME policy work to have the data analyzed further, providing a breakdown between the “micro” and SME enterprises. Cross-tabulation of the data would also be of some considerable value. And finally, it will remain important to report the results of a variety of F-test on the data, in an attempt to perform testing of various hypotheses (that imply invoking null hypotheses of “no association”) on the data.

Table4: Median profits of MSMEs by size and gender of owner					
		Female Owners		Male Owners	
Size		Actual hours (Taka/work/year)	Full - time Equivalent (Taka/work/year)	Actual hours (Taka/work/year)	Full - time Equivalent (Taka/work/year)
Number Of workers	1	8,209	10,108	26,800	17,269

	2-5	5,571	4,795	17,833	11,247
	6-10	21,900	9,456	11,378	15,652
	11-20	10,862	10,418	14,800	12,458
	21-50	12,067	2,449	6,667	7,679
				6,313	8,030
	51-100				
Total		6,943	7,344	19,000	13,102

Source: (Daniel, 2003)

4.5 It is **not a little** striking that, while the smallest enterprises should be registering such *above-average* net profitability, they should also be the objects of such sustained discrimination compared with *larger enterprises* when it comes to the question of accessing bank finance, or benefiting from other kinds of patronage, or indeed *other service inputs* such as mentorship. If the smallest of the enterprises can return such pretty stellar performance living by their own wits and due diligence, their financial prognoses would obviously become even much promising if policy-makers and their market rivals would only allow the *playing-field to be just a little more level*.

4.6 Having said that, the Taskforce is obviously under no delusion that the smallest enterprises are unlikely to present the *most naturally advantageous point of intervention* for any *service-delivery* program, should one be considered. The average cost of delivery (per unit of service delivered) is likely to be *much higher* if the smallest enterprises were to be chosen as the *focal point of the intervention*. Economics would appear to dictate that it is the largest among the small enterprises, and the medium-sized enterprises in the *booster industries* which, by virtue of significantly greater absorptive capacities and greater scales of output

would, return *greater cost-effectiveness* in the results obtained. The Taskforce would return later to the *selection criteria* to be put forward as a part of its report.

Chapter III

DEFINITION OF SMEs AND IDENTIFICATION OF BOOSTER SECTORS

1.0 Definition of Small and Medium Enterprises:

1.1 Manufacturing Industries: For manufacturing industries, the Taskforce defines:

- (e) **Small Enterprise:** an enterprise should be treated as *small* if, in today's market prices, the replacement cost of plant, machinery and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and building, were to be up to Tk. 15 million;
- (f) **Medium Enterprise:** an enterprise would be treated as *medium* if, in today's market prices, the replacement cost of plant, machinery and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and building, were to be up to Tk. 100 million;

1.2 Non-manufacturing Industries: For non-manufacturing activities (such as trading or other services), the Taskforce defines:

- (g) **Small Enterprise:** an enterprise would be treated as *small* if it has less than 25 workers, in full-time equivalents;
- (h) **Medium Enterprise:** an enterprise would be treated as *medium* if it has between 25 and 100 employees;

Some rationalization of this twin definition now seems to be in order. First, it is believed that most small enterprises don't require very much of fixed capital---perhaps, in the vicinity of several tens of hundreds of thousands taka worth. For instance, in light engineering --- the archetypal kind of industry in which small enterprises abound---the cost of setting one up is almost always well within the mark of Tk. 15 million worth of investment. Second, a fabric-making establishment with a capacity say of some 5 million yards of output a year is only likely to cost up to Tk. 100 million by way of the replacement cost of plant and machinery to set up. While the first is an archetypal of the outer limit of what a small enterprise can take, the latter is representative of what a medium enterprise can take. Third, the decision to omit land from the definition of eligibility is easily defended: land in Bangladesh has been subjected to a valuation based on *speculation*, not market forces based on *cost-based analyses*: many entrepreneurs who self-select themselves into creating *enterprises* on their *own land* could be excluding themselves from legitimate *public assistance* if land were included. Fourthly, many entrepreneurs habitually think of the input of land into the economics of their own enterprises as a *service to be bought*, not owned outright.

2.0 Rationale for picking *booster-sectors* in Bangladesh

We now turn to considering the *rationale* for legitimate public interventions to promote the cause of SMEs in the growth of employment, investment and output in Bangladesh.

Where others have used the coinage of *thrust sectors*, we have chosen to go with *booster sector* (as in *booster rockets* in a multi-stage rocket). The latter seems to resonate better with providing a boost not just to the growth rate of the sector in question but also, through backward and forward linkages, to those of the associative sectors as well.

Before proceeding any further, we must address more fully as to why we concern ourselves with establishing the rationale for publicly intervening. Aren't these rationale common knowledge by policy-makers? Aren't they axiomatically accepted among the community of practitioners? What can prevent the Taskforce from coming directly to a short list of promising industries in which SMEs numerically abound? Are these rationale worth the trouble?

Discussions in various past workshops on SMEs evinced relatively scant exposure to these rationales for assistance. The Taskforce consider it to be a lapse. This is because any promotional strategy is, by definition, *prescriptive* (and not assertive). All too frequently, promotions claimed to be legitimate and necessary were divorced from any discussion of precisely *why* public interventions were needed in the first place. Because some sectors need to be *prescribed as more eligible than others* for public assistance (which has to be *earned on one reasonable criterion or the other*), it is imperative that prescriptive rankings be followed up with disciplined rationalizations: they allows a structured approach to a debate. If recommendations or prescriptions were *based on nothing more than personal value judgements*, this would invite a failure by design of the Taskforce. Prefacing our *prescription* with diagnoses in terms of some *failure of the system* or of some *over-arching* rationale (that runs in terms of *providing leadership to a myopic marketplace* to bring the *appropriate kind of structural change in the economy*) was accepted as a requirement.

3.0 Criteria of sectoral targeting

We present the detailed discussion of these rationales in Appendix-2 to this report. For present purposes, we merely present these criteria of sectoral targeting, in their bold relief. We believe the following are the main operative criteria:

- (7) Strong comparative advantage:** Sectors in which *factor endowments* are such as to confer strong comparative advantage compared with others qualify as a booster. Comparative advantage will be judged in terms of the sector's domestic resource cost (DRC).

- (8) **Rising demand:** commodities for which *marginal budget shares* are higher than *average budget shares* are those for which demand is rising at a *higher-than-average* rate.
- (9) **Backward and forward linkages:** Some processing industries---agro-processing is an apt example---can capture well forward and backward production linkages with other sectors.
- (10) **When the playing-field is not level:** Markets virtually never perform as in the text-books, but are frequently skewed due to vast economic inequalities, asymmetric distribution of information, knowledge, and social-networking connections. Careful public interventions are needed so that a broad symmetry of resources can be made to prevail.
- (11) **The need for structural transformation is not transparent to the uninitiated**
The technology shelf---the inputs, and how they can best be combined---and the demand-mix are not *static* but is evolving fairly continuously. This forces on markets the responsibility of signaling the *need* and, more difficult, the *nature* of structural transformation that can *facilitate* survival. In this context, ***Governments are supposed to have a superiority in terms of access to strategic information versus the private-sector.*** Based on this, the creation of *new institutional delivery chains* can legitimately be posited, to deal with the imperative of structural transformation in the economy.
- (12) **Structure of incentives: manufacturing vs. trading**
In globalization, the formidable market power of global brands result in a structure of economic and financial incentives in the market place that is inimical to the domestic manufacturer versus the importer. It is arguable that a similar shift in the business *mindset* is enveloping Bangladesh: trading is a safer, smarter, richer and bulkier business than domestic manufacturing is. Managing workforces is nightmarishly difficult, as technical workers are exceedingly foot-loose, and manually-skilled workers are fractious. Manufacturing requires a much greater presence on the ground, and visibility invites extortion in the semi-anarchic conditions in Bangladesh.

4.0 Identification of booster-industries

By now, we have identified all the *market and policy failures* that hobble the performance of the SMEs and have clearly expanded upon the rationale for various interventions recommended. It now remains to pick the industries to be recommended as *booster sectors* for a *time-horizon of, say, 3 years*.

The following are the industries:

Electronics/Electricals

Rising demand/intensively requires innovation

Software-development

Structural change/intensively requires innovation

Light-engineering and metal-working

Linkage effects/natural survivability

Agro-processing/agri-business/plantation agriculture/ specialist farming/tissue-culture;

Strong comparative advantage/linkage effects

Leather-making and leather goods

Linkage effects

Knitwear / Ready-made Garments

Rising demand

Plastics and other synthetics products

Rising demand

Healthcare and diagnostics

Structural change/rising demand

Educational services

Structural change

Pharmaceuticals/cosmetics/toiletries

Structural change/rising demand

Fashion-rich personal effects, wear and consumption goods

Natural affinity to female-centric entrepreneurship

5.0 The rationale for our selecting these industries

- i. **Electronics and electrical**-computer components, peripherals, stabilizers, UPS, amplifiers, switches, plugs, printed circuit boards (PCBs), etc.---is legitimized owing to *rising demand*, as they provide among the foundation of industrialization and urban development. Given the per capita income of Bangladesh, they are characterized by high degree of linkage effects: while their growth spurs the demand for investment goods required in their production (backward linkage), the forward linkage part is likely to come from requirement for repair/maintenance services.
- ii. **Software-development** is worthy of selection because they intensively use knowledge of digital and/or *web technologies*. This is therefore easily accommodated on the basis of *structural change*. Furthermore, the marginal budget share of software-services in the countries in the Western world---the engines of the global division of labor---is a lot higher than the ABS. This is therefore a industry facing *rising demand, too*.
- iii. **Light engineering and metal working** is an industry in which *local nature of the markets to be served* implies that the typical output batch is fairly small, compared with *minimum efficient scale* (MES) of globally-branded companies. This offers a certain extent of *natural protection from competition*. In addition, this industry is suffused with both backward and forward linkages.

iv. **Agro-processing/agri-business/ agriculture plantation /specialized agriculture** industry in Bangladesh has a future for itself. Its selection is anchored in *strong comparative advantage* and *rising demand*. However, the Taskforce would recommend that it had better be the agro-processing industries of the *non-traditional type*, of the kind that moves away from rice milling and flour milling. We need agro-processors who essentially meet the following criteria:

Intensively use farm produce that boast plentiful marketed surplus, and in addition are complementary to fixing nitrogen in the soil;

Have enterprises and entrepreneurs who can deal with what it takes to successfully negotiate the hurdles implied by increasingly rigorous phyto-sanitary, and other epicurean restrictions in the importing countries;

v. **Leather and footwear** is driven by the recognition that the livestock sector in Bangladesh has ways to go in terms of matching the yield rates even in neighbouring India---not to speak of China (where they are even higher). This suggests that leather production in Bangladesh has ways to go. Clearly, the production of footwear, in large part for exports, is a natural ambition for a SME roadmap. This industry is really suffused with backward and forward linkages.

vi. **Knitwear** can be rationalized in terms of *rising demand* and *strong comparative advantage*.

vii. **Plastics and other synthetic products** (such as resin) have been known to lead factor substitution, and has been selected on this basis. This sub-sector has registered among the highest growth rates of any, according to Table-2 in the above.

viii. **Healthcare & Diagnostics:** The Taskforce recommends this subsector largely based on its rising demand domestically. Moreover, growing size of domestic market for specialized diagnostics has started to create opportunities for *legitimate import substitution*.

ix. **Educational Services:** Bangladesh is clearly surplus in human beings. To convert human beings into human resources must surely be a service industry worth hundreds of billion of Taka worth of potential market size. And quality education that keeps successfully following the *money trail* meets the bill of both *rising demand*, and *structural change*.

x. **Pharmaceutical, cosmetics and toiletries:** In 2005 and beyond, Bangladesh is one of the few countries in South Asia to benefit from an exclusion from the patent regime being globally introduced by World Trade Organization (WTO). This by bringing forth some significant competitive advantages of pharmaceutical companies will likely create opportunities, especially in the medium-enterprise category, for that industry in Bangladesh. It is important therefore to accent public assistance in that particular direction in order to take advantage of such a market possibility.

xi. **Fashion-rich personal effects, wear and consumption goods:** The Taskforce accepts at least one booster sector to be selected based on the need to concentrate efforts for promoting women entrepreneurs. The Taskforce believes that when it comes to leadership in matters of aesthetics, fashion and design delicacies, women entrepreneurs have an innate advantage.

Chapter IV

OBSERVATIONS AND FINDINGS OF THE TASKFORCE

1.0 The “vulnerabilities” of SMEs

1.1 Many authors, including from India, have drawn up list of various vulnerabilities of SMEs. And once again, it is clear that such lists merely recount where SMEs falter, without making a distinction between where they falter due their own intrinsic weaknesses (justifying no public interventions) compared with where they falter due to *market or policy failures, or due to non-existence of markets, or due to increasing returns to scale*. This becomes quite clear from an examination of the following two boxes (box-2 and box-3).

1.2 If SMEs have to make a difference, they need to be competed on an even basis. The undeniable fact however is that there is a seemingly unbridgeable chasm between the competitive situation (capital, information, access to the powerful, educational attainment, etc) between the small and large enterprises. (Markets are thoroughly imperfect and large firms dwarf SMEs in terms of *supra*-market influence and power.) Besides, it is also undeniable that a collapse in the cost of communicating across vast distances has tended to *unify global markets* like nothing before, as has a growing homogenization of consumption preferences: both have made competitive pressures even more intense. This has transformed the market dynamics, of which large as well as SMEs are merely parts. The competition is more chillingly intense now; the product life-cycles are shorter; production batches are smaller; information and communications technologies (ICTs) are much more of defining characteristics of a contender that counts. All of these add to the pressures under which SMEs have to operate.

1.2 According to Bangladesh Enterprise Institute, the following are the constraints to the growth of SMEs in Bangladesh:

Box-2: Common constraints to the development of SMEs in Bangladesh

1.	Lack of capital Lack of adequate investment; Lack of modern technology; High rate of interest on bank loans;
2.	Inadequacies of physical infrastructure Irregular/inadequate supply of power; Poor physical infrastructure and high transportation cost; Poor information about market opportunities and requirements.
3.	Inadequacies of markets/incomplete markets Inadequate availability of raw materials; Lack of skilled technicians and workers; Lack of research & development facilities;
4.	Other hostile/inimical conditions Fierce competition; Absence of effective and transparent legal system.

Source: Bangladesh Enterprise Institute, 2004.

Note: The headings and categorization have been suggested by the Taskforce, (even though the individual issues are the creation of Bangladesh Enterprise Institute).

Box-3	Common constraints to the development of SMEs in India
	<ul style="list-style-type: none"> Low capital base 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

The similarity of the two slates of “presumed constraints” is close indeed.

1.3 Only some of the entries in box-2 and 3 above have a blow-by-blow equivalence or correspondence to *market failures* or *government failures* or any of the other well-agreed *raison d’etre* for public interventions in markets. Not each one of these really amounts to a market failure which hobbles SMEs ***only and not large enterprises too.*** For instance, poor infrastructure in Bangladesh ails large firms too, as does the absence of an effective and transparent legal system. Of course, large firms don’t allow these *generically-relevant* handicaps to put a crimp on their operating results. But that may simply be because they have *preferred access to credit markets or capital markets*---privileges that SMEs *don’t have*. It is credit markets in this case

that *fail with sectional handicaps*, thus rationalizing public interventions *with sectional constituencies*: not public infrastructure. The implications are crystal clear: a pitch for more investment on public infrastructure does not really belong in as SME-only slate of public interventions. A pitch for making more financial resources available for channelling into SME financing clearly belongs there.

1.4 This is not to say that SMEs won't benefit financially if infrastructure were to be improved. They would. Point is that investment on infrastructure would benefit *all sizes of enterprises: it is unlikely to remove what handicaps SMEs from competing evenly against large enterprises*.

1.5 Another test is where it is possible to *exclude* firms in other than the target category from benefiting from the interventions in question. This test spells the difference between generic vulnerabilities (which strictly don't warrant ameliorative interventions with sectional targets), and vulnerabilities that result from *discrimination* in the market-place or failures of policies (which do warrant them).

2.0 Catalogue of market and policy-failures

2.1 The Taskforce have therefore exercised its prerogative to put down a handful of handicaps which affect SMEs *differentially* compared with their competitors. They appear in box-4:

Box-4: The Taskforce's own diagnosis of the most important rationale for action

Lack of capital

Utter scarcity of social venture (equity) capital, where pay-back period is long;
Constrained allocation of bank finance;

Tax administration

SME *manufacturers* are dealt an unfair hand by the NBR compared with their trading competitors.

3.0 Lessons from international experience

The Taskforce has been benefited from the assimilation of several major lessons from recently-concluded Ministerial Conference on SME Development in Istanbul, held under the aegis of the Organization of

Economic Cooperation and Development (OECD). Several of the most important lessons are as follows:

2.4 Because a considerable extent of strategic stewardship and gap

filling---with the gaps in question not being visible to the private decision-makers--- is typically required in this kind of structural transformation, a three-way set-up, involving the government, civil society and the private sector, is typically required. Only the government can be entrusted the central role of the architect of the change management, with the provision that it will formulate a broad plan of actions and then a much more detailed action programmes in the interest of execution. Government and civil society institutions in question typically also needs technical assistance and capacity building so as to attain maximum cost-effectiveness. That is why such improvement in the competitiveness of SMEs versus large enterprises typically requires a modification of the structure of public investment in desired directions. The policy and institutional-delivery set created for the development and empowering of the SMEs should be promotional, catalytic, incubatory and selective, and should not involve indiscriminate subsidies. To the extent that removal of specific market failure or previous government failure or negative pecuniary externality puts a premium on the creation of a package of financial incentives, then perhaps a small quantity of subsidies may also be justified. There is precedent in Asia of well-directed government intervention in a coherent package of ameliorative and stimulative action, including of channelizing strategically-focussed and small dose of financial subsidies, in the interest of fostering the growth of SMEs. Perhaps, a similar case can be made for SME development in Bangladesh, too.

2.5 It is important to foster the evolution of a congenial, transparent and simplified *regulatory* framework that keeps low the compliance costs of an enabling environment for SMEs, and especially small enterprises. By avoiding invasive procedures (such as rent-seeking behavior, etc) and keeping cost of compliance low, many countries have integrated informal-sector enterprises in mainstream SME development.

4.0 Elements of SME policy

4.13 Development of SMEs is increasingly being held at the highest echelons of policy-making globally, as a permanent and integral part of **poverty-reduction strategy** of the governments of developing countries. Success here will require acting decisively in terms of making SMEs' scarce financial resources go further, and harnessing, up to the hilt, human resource and institutional capacities of the stakeholders in SME development.

4.14 The archetypal small-ticket manufacturers, often closely associated with occupational categories with a social accent, such as *jolhas*, *tellis*, *sonars*, *kamars*, have been crowded by middle-class elite, and this denial and the associated divide calls for a correction through proactive intervention.

4.15 With liberalisation apace, withering competition from more entrenched countries and globally-branded companies operating on a global scale, and with deviations from the *rule of cascading* in the setting of border tariffs, trading has become a career of choice in Bangladesh at the expense of manufacturing for many who would have otherwise worn happily the mantle of a manufacturer.

4.16 There are systematic handicaps which choke the SMEs' entrepreneurial drive or put a crimp on their choices, and thus drag their net performance, *versus* their competitors'---thus justifying prescriptions which selectively impact SMEs in an effort to alleviate, if not remove altogether, such handicaps.

4.17 In an age of sweeping globalization, and growing penetration of information and knowledge technologies into the emerging international division of labor, appropriately positioning Bangladesh's SMEs in the resulting structural transformation of the global economy is seen as an important basis for both selecting the booster industries as well as the enterprises deserving injection of public assistance that benefit them.

4.18 While governments often perform poorly in production, they have (or at any rate can potentially acquire at low cost) an innate advantage in terms of acquisition, dissemination and maintenance of a base of information and knowledge of a kind that enhances productivity of private investors' business decisions in an inclusive manner. In addition, governments by virtue of its vastly superior catalytic or mobilizational potential have ameliorative role(s) to play when either markets fail, or externalities skew private investors response in sub-optimal ways or when venture-capital is in too short a supply for the nation's good in high-risk-high-gain investment opportunities. In such cases, there is a well-grounded rationale for public intervention, including a provider of equity capital, a practice in which a modest beginning has already been made in Bangladesh.

4.19 It is very important to know what the elements of SME policy are. The main ones require that:

- (5) the government accords to SME development an integral and vigorous role in the overall management of growth and poverty-reduction;
- (6) identify and establish the network of infrastructure and institutional delivery mechanisms that facilitate the promotion of SMEs;
- (7) especially existing regulatory framework and government support institutions be re-oriented towards bolstering the goals of SME policy;
- (8) nurture and partner civil-society institution(s) having credible management teams in terms of the delivery of needed services, leadership, initiation, counseling, mentoring and tutoring; etc.

4.20 Create innovative but meritocratic arrangements so that deserving and especially small enterprises with desired entrepreneurial antecedents and promise can be offered financial incentives within industries prescribed on some well-agreed bases.

4.21 Dispute settlement procedures should proactively shield small enterprises especially from high legal costs and insidious harassment.

4.22 In order to assist small enterprises in dealing with their pervasive lack of access to finance, avenues of mobilizing debt without collaterals to match (either using *debt-guarantee schemes* or mapping *intellectual-property capital* into *pseudo-venture capital*) must be urgently created.

4.23 There is a need to systematically accord precedence to small enterprises *versus* medium enterprises, within the limitations of government's resources.

4.24 Governments are increasingly harnessing information & communications technologies, Internet Protocol (IP)-based infrastructure, and electronic-governance in an effort to parlay regulatory services, all kinds of useful information and mentoring inputs, with an accent on increasing the viability of SMEs in all sectors of the economy.

5.0 Proactive Lending Package for SMEs

The credit crunch putting pressures especially on small enterprises must be alleviated. Towards this end, worthy business ventures in designated SME booster sectors should be declared eligible to loans that are carefully scoped and appraised for their bank ability. We recommend that BASIC Bank be declared the Lead Bank for the delivery of such credit on concessionary terms. (Over the medium term, the proposed SME Foundation would take over from the BASIC Bank the channelization of finances for SME development.)

6.0 Venture Capital

The Taskforce recognizes that the knowledge-economy has greatly increased the stakes to investments that are *outward-oriented*, have a high degree of intellectual-property (IP) content, and a high degree of *leakage* in the returns to such investment. Examples are software-development, manufacture based on the development of prototypes, creation of design leading to prototyping, enterprises naturally akin to creating intellectual-property, etc. In every case, there is an intractable degree of *seepage* of shareholder value: in economics, this refers to externalities. When externalities are outward, private rates of return tend to be lower than social rate of return, causing relative under-investment in such products or services. Gestation lag would on that account tend to be longer. Risk-averse private venture capital would likely be stifled by such longer gestation lag. Hence the imperative in such products or services for public venture-capital participation, so as not to stymie potentially remunerative private enterprise. Information-technology and electronics---two industries who in any case are closely inter-related---are prime examples of such negative externalities and, therefore, of such public venture-capital participation.

Such social commitment to the availability of *risk capital*, responding to the *special circumstances of technologically-nuanced* fields of enterprise development, is widely accepted as *effective practice* in India for example. The Small Industries Development Bank of India (SIDBI) has already set up a venture capital fund. Rating for possible funding is done using a thoroughly transparent and meritocratic process, overseen by a team of subject-matter specialists, who act independently and conscientiously. Such professional vetting is not challenged by the Chief Executive of SIDBI. The Taskforce recommends something similar for adoption in Bangladesh. We recommend that BASIC Bank be selected as the custodian of all social equity funding into SME development.

7.0 Restructuring tax-package for very small manufacturers

The Taskforce believe that for SMEs, the VAT by being collected *ex-factory* increases the likelihood of *double VAT taxation*. The onus of the proof of first-time VAT payment to the tax assesses, the SMEs, leads frequently to denial of payment-credit. The small enterprise does not have enough clout *vs* the large trader, who had sold him the commodity, to press his need for documentary proof about VAT payment at the border. The

small enterprise often ends up paying the VAT twice over on account of imported inputs. However, the most insidious part in all this is the nagging harassment by the officials, which leads to abject demoralization of the entrepreneurs who deserve better.

We recommend that small enterprises with fixed investment (without including land and building) of up to Tk. 3 million be declared completely exempt from paying any obligation to pay VAT. Manufacturing enterprises with fixed investment ranging between Tk. 3 million and 15 million (again excluding land and building) shall pay turnover tax at the rate of 2.5% (two and a half percent).

We recommend that such very small enterprises (with up to Tk. 3 million in fixed assets not counting land and building) should be given a tax holiday for 7 (seven) and 10 (ten) years from their initiation, for enterprises in the cities of Dhaka/Chittagong and all other areas/locations respectively. Both recommendations (a) and (b) will, we propose, be applied in **all** industries, not just the boosters.

India exempts all small manufacturing enterprises with capital investment under Rs. 1 crore from all types of excise duty. Besides, they have formed a separate Ministry for Small Scale and Micro-Industries.

8.0 No departure from the principle of *duty cascading*

At present, a UPS for computer is totally tax and VAT free if imported with a computer, and one has to pay only 7.5% import duty if imported separately. On the other hand for local production of UPS one has to pay 40% to 100% tax and VAT at import on different raw materials and spare parts.

VAT for imported UPS at the point-of-sale (POS) is zero. In sharp contrast, a local manufacturer is required to pay VAT at the rate of 15% per schedules prescribed by the NBR.

The same applies for computers and solar PV generator systems, almost all of which are electronic. Local capabilities exist to produce high quality UPS and the main electronic circuits for solar PV systems, but the Government tax policies have not only left the local producers unprotected, they did not even allow the local producers to play on a level ground. The existing policies also deterred local producers from attempting at producing or assembling any other parts of Computers and Solar PV systems. The suggested clauses will allow the local producers at least to play on a level ground, and will also deter such unreasonable reduction of tax and VAT on imported finished products.

The total incidence of all taxes at import (Import duty, Advance Income tax, Development surcharge, VAT, etc.) on the raw materials and spares of locally produced commodities must not, owing to the generally-accepted principle of *cascading*, exceed that on corresponding finished imported commodities. If such taxes for a finished commodity are reduced at any time, then the taxes on the raw materials and spares of that product will automatically stand adjusted following the above principle.

If VAT at sales is waived or reduced on an imported finished product, the total VAT collected for the same product at the point of manufacture and at the point of sales shall not be more than the above VAT at sales for the imported product, and this will also be activated automatically.

9.0 Medium-term Tactical Plan of Action

A tactical plan of action is needed preparatory to ensuring that an enabling environment is created in which both extant and aspiring SME entrepreneurs find within an easy reach most of what they direly need---information, counseling, mentoring, access to finance, and marketing and technical assistance.

More specifically, the tactical plan will entail articulation of delivery chains for *technopreneurship*---a hybrid using functioning entrepreneurship in technologically-steeped lines of productive ventures to produce goods which enjoy high marginal budget shares but also demands mentoring in incubators---some kind of a crucible where the green young are moulded into increasingly savvy entrepreneurs under the watchful oversee of the veterans of industry.

10.0 Capacity-building

A capacity-building package will be needed to keep the process of SMEs development speeding along.

The tactical plan aiming at creating an enabling environment with regard to the availability of information, counseling, mentoring, access to finance and markets will be needed.

Fostering a *supply chain for technopreneurship* will be emphasized. Towards this end, mobilization campaign will need to be mounted to spur interest by intelligent and diligent people in careers of successful entrepreneurship. The SME Panel/Cell might usefully conceive programs in popular media, and motivate appropriate anchor(s) for them, modeled after some highly-regarded success stories.

The Taskforce would like to recommend a ground-breaking approach towards bonding and harnessing an entire **online-community** of both extant and aspiring SME entrepreneurs, to be hosted on a SME portal in the SME Cell, for the divining of technology, product and market trends, for career-counseling to benefit science/technology graduates, for technopreneurial problem-solving, for mentoring using *guru-shisya symbiosis*.

A Web-based virtual *front-office* providing all start-up assistance to SME entrepreneurs (application forms, FAQs, limited directory-assistance, success stories, horror stories, etc): an *one-stop-service*, with all interactions between the user and the system stored on databases in the interest of providing institutional memory.

Information regarding standards of labor and output pertaining to overseas markets to benefit export-oriented SMEs should be put on the Web portal.

A high-performance fiber-optics communications backbone be put in place in all six of the country's largest metro-markets (namely, Dhaka, Chittagong, Rajshahi, Khulna, Sylhet and Barisal) so that SME entrepreneurs there can increasingly be in sync with the fundamental drivers of competitiveness in the new economy.

We all know that technology now enables the migration of the cluster eco-system(s) to Web-based structures and communities, in which the MOI and other stakeholders can be motivated to create *portlets* conducive to sharing of SME-friendly content or *knowlets*: here, information and communications technologies will need to be pressed into service.[\[6\]](#)

11.0 Availing of the principle of *locational self-selection*

The old-quarters within large metropolis such as Dhaka and Chittagong hum with much small-scale production. This is where most of the production clusters in which SMEs abound can be found. Clusters are like eco-systems in which the small entrepreneurs have themselves forged a certain, mostly highly intelligible, division of functional specialization over many years of time. Sometimes, these output hubs also migrate towards the suburbs, to escape the crush on narrow roads. Either way, targeting these small, own-account proprietors, whose own lives often typify rags-to-riches stories emphasizing sheer hard work, is one way to press into service the first-principle of *self-selection*. *The rich does not go to inner city to make a living*: this in one line is the epitome of justification for what we have just said about self-selection. Entrepreneurs who try to make a living within the crush, the congestion, the crime and the foul smell of the inner cities in any of the nine booster industries certainly pass the first principle of *locational self-selection* to qualify for some measure of public assistance.

12.0 Training

BSCIC---mainly in the form of SCITI---, BIM and BITAC are all institutions in the MOI with a great deal of past investment in equipment, infrastructure and trained human resources. It is agreed that currently a fair proportion of these resources are inadequately utilized. The OECD has emphasized that quickly enhancing human resource and institutional development capacities is a *sine qua non* of letting SMEs contribute their fullest towards poverty generation in the current globalization scene. BSCIC/SCITI, BIM, and BITAC should undergo a significant strategic reorientation of their own core competencies under the watchful eye of the Advisory Panel/SME Cell. In particular, the skills and competencies needed to enable SME hold their own in the booster-industries in the changed global business environment should be re-emphasized in the ensuing revamping of these institutions.

Towards this end, technical assistance and investment are both urgently needed to appropriately accent the training and motivational in these institutions so that they can become durable fixtures of technical and managerial skills can be nurtured, in a format of public-private partnership.

Chapter V

TASKFORCE'S RECOMMENDATIONS

1.0 Identification of Booster Sectors

The following industries, including one based exclusively on the imperative to foster women entrepreneurship, are prescribed by the Taskforce for *preference* in terms of prospective public assistance and capacity-building programmes, within the limitation of a review every three years:

Electronics and electrical;

Software-development;

Light engineering and metal-working;

Agro-processing/agri-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;
Pharmaceuticals/cosmetics/toiletries;
Fashion-rich personal effects, wear and consumption goods;

Notwithstanding the prescriptive nature of the foregoing recommendation, non-classification as such should not disqualify an SME from financial assistance from any scheduled banks.

3.0 Policy recommendations

The Taskforce has organized its recommendations in three groups in order of their underlying time-horizons: short-, medium- and long-term.

- d. By short term, we mean actions whose impact may be felt between now and 18 months away.
- e. By medium term, we mean actions whose initiation could take up to 18 months, whose fruition could well take between 18 month and 4 years.
- f. Long-term is defined as something that takes more than 4 years to fructify.

3.0 SHORT-TERM POLICIES

3.1 *Framing and carrying out policies for SME development*

- a. The Government shall make an unambiguous **policy statement** declaring that the Government consider SMEs, especially small enterprises, as an integral and important element in the cause of economic growth and poverty alleviation in Bangladesh.

- b. An **SME Advisory Panel** shall be constituted to perform the services of a *specialist brain-trust* for the Ministry of Industries (MOI). Likewise, an SME Cell shall be set up in MOI to help implement the SME policies. The present SME Taskforce shall continue to exist so as to monitor the state of the implementation of its recommendations.

The Panel may comprise a few of the members of this Taskforce, other subject-matter specialists representative of the booster industries themselves, one or two certifiable role models of mass awareness-raising to generate mass interest in technopreneurial careers. In the medium term, the Advisory Panel and the SME Cell will eventually morph into what we call a **SME Foundation** (this is further detailed under the rubric of medium-term recommendations of the Taskforce). The Panel will report to the Minister of Industries. The tactical plan of action is about what it will take to move SMEs forward the way they should.

- c. A **roadmap** and a **tactical plan of action**, may be conceived and then detailed by **SME Advisory Panel** and the **SME Cell**.

3.2 Definition/Identification of SMEs

Defining enterprises for targeting purposes in terms of either fixed investment or head-count is a well-established policy practice, for instance in India. A one-attribute definition typically reduces the proportion of *indeterminate* cases compared with a two-attribute one. Any definition, no matter how well-thought-through, is bound to involve some degree of arbitrariness.

- a. For **manufacturing** industries, the Taskforce recommends that:

- ◆ **Small enterprise:** an enterprise should be treated as *small* if, in today's 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 buildings, were to be up to Tk. 15 million;
- ◆ **Medium enterprise:** an enterprise would be treated as *medium* if, in today's market prices, the replacement cost of plant, machinery, and other parts/components, fixtures, support utility, and associated technical services (such as turn-key consultancy), etc, excluding land and buildings, were to be up to Tk. 100 million;

d. For **non-manufacturing** activities (such as trading or other services), the Taskforce defines:

- ◆ **Small enterprise:** an enterprise should be treated as *small* if it has less than 25 workers, in full-time equivalents;
- ◆ **Medium enterprise:** an enterprise would be treated as *medium* if it has between 25 and 100 employees;

By making the definition especially of small enterprises more inclusive with a lower threshold for assistance eligibility, the outreach of SME policy for poverty alleviation and employment generation has been augmented *versus* all past statements of industrial policies.

Proposed definition sets the threshold smallness at a much lower level compared with the treatment in the existing Industrial Policy of Bangladesh. The Taskforce recognizes that there will remain a need for National Board of Revenue (NBR) and other implementation arms of the government to incorporate the definitions in the declared SME policy within their own operating environment.

3.3 Setting criteria for deserving enterprises

Enterprises which, as well as meeting the size requirement proposed by the Taskforce, shall have

- h. proven credentials as an entrepreneur (for example, membership in well-recognized social occupational groupings, successful track record) with requisite presence and facilities on the ground;
- i. an above-average *insiders' equity participation*;
- j. certifiable professional specialization of top-management in relevant production skills;
- k. the stamp of approval from globally-recognized quality-assurance bodies (ISO 9001:2000, for example);
- l. High management commitment to innovation.
- m. Women entrepreneurs will be accorded preference, wherever appropriate.
- n. Other things being equal, smaller enterprises shall be given preference in terms of benefits from interventions by the government and civil society initiatives.

3.4 Rationalization of VAT and other budgetary measures

- a. We recommend that very small manufacturing enterprises with fixed investment, excluding land and building, of up to Tk. 3 million (three million), should be completely exempt from any obligation to pay VAT. For manufacturing enterprises with fixed investment, excluding land and building, of greater than Tk. 3 million and less than or equal to Tk. 15 million, there shall be a turnover tax will be 2.5% (two and a half percent).
- b. We recommend that such very small enterprises (with up to Tk. 3 million in fixed assets not counting land and building) should be given a tax holiday for 7 (seven) and 10 (ten) years from their initiation, for

enterprises in the cities of Dhaka/Chittagong and all other areas/locations respectively. Both recommendations will, we propose, be applied in ***all*** industries, not just the boosters.

Exceptions:

The above two facilities will not be given to:

- (3) Joint Venture industries with foreign partners,
- (4) Sectors that should be discouraged based on health, environment, or other grounds such as tobacco, liquor and narcotics related industries.

d. We recommend two blanket clauses to protect local industries from irrational tax policies:

- (3) The total incidence of all taxes at import (Import duty, Supplementary Duty, Regulatory Duty, Development surcharge, VAT, etc.) on the raw materials and spares of locally produced commodities cannot exceed that on corresponding finished imported commodities. If such taxes for a finished commodity are reduced at any time, then the taxes on the raw materials and spares of that product will automatically stand adjusted following the above principle.
- (4) VAT on imported products shall not be less than that on like domestic products. Any reduction in existing VAT on imported products shall be automatically matched by an equal reduction on VAT on like domestic products.

3.5 Levelling the playing-field in credit and venture-capital markets

- (9) A credit-distribution package will need to be worked out by the Ministry of Industries. An innovative scheme---rather like a two-stage screening mechanism---that can really probe for the *bone fide* of the applicants as entrepreneur material will be deployed. Donor financial resources made available specifically to help with implementation of SME policy being enunciated here would only be allocated to competitively-selected enterprises within the booster industries here being prescribed.

- (10)** Of the total resources available, no more than 20% may be earmarked for medium enterprises, while the remainder, 80%, will be earmarked for small enterprises. Within each division, the resources will be divided up into a public-sector venture-capital fund (10%), approximately on the lines of the currently-implemented EEF at the Bangladesh Bank. The remainder will be allocated to a *credit fund*. (This does not have anything to do with debt-equity ratio relevant in discussions of enterprise financing.)
- (11)** In the short run, the distribution of the credit fund and venture-capital fund will be the task of the BASIC Bank, which is here being recommended as the lead bank, it being borne in mind that BASIC Bank will closely work with the Advisory Panel. (Over the medium term, this responsibility will devolve to the SME Foundation.)
- (12)** The Ministry of Industry and the SME Advisory Panel/Foundation, as the case may be, will determine modalities of how to implement both the credit-fund and the venture-capital fund.
- (13)** Projects to be funded from the venture-capital fund will be evaluated by a team of experts---a handful of subject-matter specialists---which will be constituted as a part of the implementation of SME Policy.
- (14)** A publicly-mandated venture-capital scheme be created in deference to the rationale cited in the main text. It will also give a stimulus to the morale of entrepreneurs who commit in-house capital to projects with novel and potentially innovative processes and technologies with demonstrable potential for commercial success. Such projects have a-typically high risk and high returns. This recommendation is rationalized in terms of the private under-investment based on extensive, even potentially crippling, negative pecuniary externalities in some among the booster industries prescribed here, with regard to the leaching of shareholder's value outward from the enterprise.

- (15) The Advisory Panel working together with the Lead Bank in the short-term, and the SME Foundation in the medium- and long-term, would implement a transparent and meritocratic arrangement for steering public equity and debt resources into a genuinely deserving selection of enterprises.
- (16) The development of human resources in both the BASIC Bank and the SME Foundation with regard to effective targeting of resources made available under public equity funding would remain imperative.

3.6 SMEs need for quality-assurance (QA) stamp-of-approval

- d. Bangladesh Standards and Testing Institute (BSTI) with its accountability to SMEs fundamentally enhanced through appropriate SME representation in its governance might become the focal point for offering assistance with regards to securing *quality-assurance (QA) certification from registrars of QA*.
- e. Suitable SME-related industry association(s) should be empowered to issue non-mandatory certification, albeit with high professional integrity, with regard to quality assurance. Such association(s) would be eligible to grants from Government towards the cost of setting up required testing laboratories and other facilities.
- f. Small, out-right co-financing grants may be available for registration with globally branded QA registrars (say with ISO 9001: 2001 or equivalent).

3.7 Multi-stage sample survey of SMEs

There is an urgent need for a major overhaul of the availability of reliable and current *data* about the characteristics of SMEs. The Taskforce recommends that the Ministry of Industries immediately take up the conception and implementation of a *multi-stage sample survey of SMEs in the metros and the district headquarters*. Ideally, there should be a complete enumeration of all SMEs, the data from which should be of use in drawing up a survey methodology for a systematic stratified random sampling.

4.0 MEDIUM-TERM POLICIES

The OECD have recently opined that one of the major challenges of transitional and developing countries in this age of sweeping globalization is to ensure rapid development of the SME sector by harnessing *scarce human and institutional capacities* in availing of trading and investment opportunities. In consonance with this imperative, the Taskforce puts forward a package of medium-term recommendations.

4.1 The formation of a *Small and Medium Enterprises Foundation*

- (2) Over the medium term and beyond, the Government **must** remove all remaining obstacles impeding the formation of an SME Foundation. While the Ministry of Industry will still remain the sovereign source of all policies, the proposed SME Foundation will become the focal point for all planning, developmental, financing, awareness-raising, incubation, advocacy, monitoring and evaluation services in the name of all SME development as a crucially- important element of poverty alleviation.

4.2 A tactical plan of action that leads to enabling environment

- x. The tactical plan is needed to move from *gap analyses* to *skills upgrading* based on the product(s) in the booster-sectors identified in this report, paying careful attention to the requirements of the production clusters in the inner cities (such as Dholai Khal, Mirpur, and the like).
- xi. An enabling environment in which both extant and aspiring entrepreneurs find within an easy reach most of what they direly need---information, counseling, mentoring, access to finance, technology and the means to market.
- xii. A serious effort is recommended for fostering a *supply chain for technopreneurship*. Bangladesh needs role models that can get intelligent and diligent people excited about creating value through successful entrepreneurship. It is recommended that the SME Panel/Cell and the SME Foundation conceive programs in popular media, and anchor(s) for them to match, modeled after some widely-accepted success stories.
- xiii. An online-community, availing of relevant information and communication technologies, of both extant and aspiring SME entrepreneurs, to be hosted on a SME Web portal in the SME Cell/SME Foundation, for the divining of technology, product and market trends, for career-counseling to benefit science/technology graduates, for technopreneurial problem-solving session(s), for mentoring using *guru-disciple symbiosis*. (*The Taskforce is fully aware that pulling off such innovation would require careful planning and nearly flawless execution*).
- xiv. A Web-based virtual *front-office* providing all start-up assistance to SME entrepreneurs (application forms, FAQs, limited directory-assistance, success stories, horror stories, etc): an *one-stop-service*, with all interactions between the user and the system stored on databases in the interest of providing institutional memory.

- xv. Information regarding standards of labor and output pertaining to overseas markets to benefit export-oriented SMEs should be put on the Web portal.
- xvi. Such structures of electronic-governance should be supplemented, at least for a time, by human touch, with adequate budget to match, to physically attend to the needs of small entrepreneurs who take recourse to them. This is based on the recognition that a totally hands-off delivery of all requisite services to SMEs is an ideal whose achievement was likely to only happen in stages.
- xvii. A high-performance fiber-optics communications backbone be put in place *in six* of the country's largest metro-markets (namely, Dhaka, Chittagong, Rajshahi, Khulna, Sylhet and Barisal) so that the launch of some serious ICT-centric applications to benefit e-governance to the profit of SME development is not unduly handicapped by woefully inadequate bandwidth.
- xviii. Technology-exchange programmes between countries with similar stages of development, and with a similar maturity of the infrastructural development for SME development, in the interest of rapid technology transfer.

4.3 Formulation of a package of capacity-building and training

- (8) Specialized professional expertise in carefully-chosen niches that the Panel of Advisors recommends has potential for a broad-based replication. Such training can be so packaged to such high standards that the recipients feel motivated to pay up *user charges*, however minimal.
- (9) Re-skilling *boot camps* would need to be organized for each of the booster industries by rotation, with a view to provide periodic technology grounding in efficacious skills among workers in SMEs.

- (10) BSCIC/SCITI, BIM, and BITAC---where a lot of equipment, infrastructure and other resources are in place---should undergo a significant strategic *reorientation of their own core competencies* under the watchful eye of the Advisory Panel/SME Cell. In particular, the skills and competencies needed to enable SME hold their own in the booster-industries in the changed global business environment should be re-emphasized in the ensuing revamping of these institutions.
- (11) Towards this end (as stated above), technical assistance and investment are both urgently needed to appropriately accent the training and motivational in these institutions so that they can become durable fixtures of technical and managerial skills can be nurtured, in a format of public-private partnership.
- (12) The selection of such training courses and then the delivery of such training is an important instance of *public-private collaboration*.
- (13) R & D that lead to prototypes with a scope for replication in potentially high-impact product *niches* (eg in the field of mobile games, 3-D animation, or bio-optics, or the manufacture of computer-controlled industrial and medical appliances, or spurring the use of resin in new production applications, etc);
- (14) Curriculum of vocational training institutes be revised and reviewed to make it SME development friendly.

4.4 Evolving of an SME Eco-system: Issues of Institutional Delivery Chains

Two kinds of institutions are recommended, preferably for adoption by civil society role models/ catalysts, bearing in mind that these institutions will not be in the employ of the government.

- (5) The mission of the first kind is in trying to render stakeholders out of indigenous young science and technology graduates by bringing to their agenda for poverty alleviation the currently-missing *fulcrum* of technological innovations to improve the quality of life of the poor in Bangladesh.
- (6) The mission of the second is to achieve mastery over a rapidly-changing slate of IT skills, and to then quickly disseminate them among young self-starters, including in the university/polytechnic/colleges' stream, through a regime of online and "brick-and-mortar" interactions.
- (7) Efforts to accelerate the retention and promotion of women entrepreneurs should be strengthened.
- (8) Greater stakeholder involvement in the entire gamut of activities by way of SME development while maximizing the extent of ownership to be promoted.

4.5 Mitigating Impediments in clusters

One should make an effort to identify three or four promising *lines of production* in a handful of clusters in the metros of Dhaka and Chittagong, where small enterprises abound. Gap analyses that lead to the diagnoses of weaknesses that stymie their productivity should then be launched. Several *technical assistance studies* should then be aimed at these problems.

5.0 LONG-TERM POLICIES

5.1 Education and Generational Ethos

- (7) Bangladesh should increase the number, and enhance the quality of technical education in, the country's *polytechnic institutes* in the interest of increasing the number of entrepreneurs.
- (8) Content of a kind that seed, early on in the global-view of the children, the attractiveness of entrepreneurial careers should be pressed into service.
- (9) Similarly, the accent on mathematics, science and technology fare should be made stronger in the educational curricula of schools and colleges in Bangladesh.
- (10) A census of all small and medium enterprises in Bangladesh should be conducted. This is likely to require a very large investment.
- (11) The legal and contractual framework prevailing in Bangladesh often increases especially small enterprises' handicaps. A survey of SMEs should be launched in order to identify these insidious legal irritants. These should then be systematically weaned from the world of Bangladeshi SMEs.
- (12)** A small-claims court needs to be instituted, with requisite resources and mandate to match.

Appendix- 3

CRITERIA FOR SECTORAL TARGETING

The following are some of the major criteria that could be used for ranking various sector or sub-sectors in order of degree to which they were entitled to public assistance (bearing in mind that the Taskforce was severely constrained by the lack of firm data in terms of sectoral characteristics):

Strong comparative advantage: Sectors in which *factor endowments* are such as to confer strong comparative advantage compared with others qualify as a booster. Comparative advantage will be judged in terms of the sector's domestic resource cost (DRC). DRC is the ratio between what it takes, in terms of *nontradeable domestic resources*, to produce a unit of output, to the *net value added*, in *border prices*, created by the latter. Agro-processing would be one such sector.

Rising demand: Pedagogically, commodities for which *marginal budget shares* are higher than *average budget shares* are those for which demand is rising at a *higher-than-average* rate. Marginal budget shares by exceeding the average budget shares over a period of time gradually augment the latter themselves. Just as the tide is said to be raising all boats, rising demand especially calls attention to items of assistance needed to ensure that all requisite and material inputs are available on hand, so that the opportunity represented by rising demand is not lost upon the entrepreneurs in the sectors in question. Electronics and electricals and metal-using sectors come to mind as examples here, as do software development.

Backward and forward linkages: Some processing industries---agro-processing is an apt example--- can capture well forward and backward production linkages with other sectors. Examples of backward linkages

include manufacturing industries for meat conservation, machinery, and equipment, packaging materials and intermediate goods used in the processing (of meat, milk, to give just two examples). Examples of forward linkages include tanning operations, manufacture of footwear and other leather goods based on hides and skins. Light engineering come to mind as an example, as does agro-processing.

Investment in agro-processing not only adds value to agricultural commodities, but often makes them more tradable than they would be otherwise. Commercialization requires investment in processing of commodities to turn largely non-tradable rural economies into market-based economies. Improved processing of food and other farm produce can help improve the elasticity of supply of items that urbanites mostly want, and which are otherwise not always available, or are in limited supply, as urban income increases. Such improvements allow growth gains from increased exports to be converted more fully into further new employment and production, as opposed to inflation in food prices. “Consumption growth linkages” can be many times more important to growth than technical backwards production linkages (Delgado et al., 1998).

When the playing-field is not level: Markets virtually never perform as in the text-books, but are frequently skewed due to vast economic inequalities, asymmetric distribution of information, knowledge, and social-networking connections. Careful public interventions are needed so that a broad symmetry of resources can be seen to prevail.

If markets could be counted upon to deliver results that met Imperatives of good economics, period after period, there would be no need for policy interventions. Market, however, fail, and they fail often—hence public-sector interventions are needed. Sometimes, as well as *market failures*, there will be *government failures* as well to worry about.

Yet another dimension of inequality is that a complete set of markets often don't exist in some industries. For instance, insurance markets, adapted to the requirements of small-enterprise products, are often not available. Markets for knowledge-enhancing, *knowledge-let*, products are nascent or non-existent completely.

And yet, while small enterprises have to adjust as best they can for a less-than-complete range of markets, large firms can avail of their access to the control-panels of governance in order to conjure up “by-passes” that suit them.

The Taskforce has a responsibility to identify industries in which such *market failures* are to be found.

At times, there will be *government failures* as well, to worry about. This happens when various government policies work at cross purposes, aggravating, on net basis, the *market failures* they were supposed, in the first place, to eradicate, or at any rate, to mitigate.

The returns to scale are sometimes increasing

Returns to scale are said to be increasing, when *monetary economies* are reaped as the scale of output ramps up. This is *a necessary condition* for increasing concentration of ownership in any industry. When technologies are such that they kick-in *increasing returns to scale*, public interventions are usually called for so as to prevent growing concentration of market power.

The need for structural transformation is not transparent to the uninitiated

The technology shelf---the inputs, and how they can best be combined---and the demand-mix are not *static* but is evolving fairly continuously. This forces on markets the responsibility of signaling the *need* and, more difficult, the *nature* of structural transformation that can *facilitate* survival.

For example, rising incomes, growing middle-class consumerism, and demonstration-effects-in-consumption translate into an output-mix weighted towards *durable consumption* items. For the same reason, there is a

growing shift towards designer or branded items in personal consumption. Innovative, trendy design and “fashion” content are the key to success in this very fluid *niche* space: both put a premium on *knowledge* and continuous *technical innovation*. For small enterprises, to take advantage of this shift puts a premium on *foresight and innovation*. Information and sure grasp of knowledge as to how to make the transition is the challenge: such things call for *custom-built structures* of public delivery mechanism, as markets don’t exist for these inputs or resources.

Again, these days, *knowledge coefficient* in all manners of production is growing: the international division of labor is also reflecting this fact.

Strong imperatives to or compulsions for *structural transformation or structural change*---which necessitate compensating variation in *stakeholder behavior or conduct or responses*---provide a rationale for public interventions.

Structure of incentives: manufacturing vs. trading

In globalization, the formidable market power of global brands result in a structure of economic and financial incentives in the market place that is inimical to the domestic manufacturer versus the importer. It is arguable that a similar shift in the business *mindset* is enveloping Bangladesh: trading is a safer, smarter, richer and bulkier business than domestic manufacturing is. Managing workforces is nightmarishly difficult, as technical workers are exceedingly foot-loose, and manually-skilled workers are fractious. Manufacturing requires a much greater presence on the ground, and visibility invites extortion in the semi-anarchic conditions in Bangladesh. The Taskforce members heard this refrain again and again during its deliberations. Globalization and liberalization were often likened in these deliberations to exceedingly sharp, surgical knives: they can save precious lives only if they are wielded by *highly-specialized and –experienced surgeons*. The probability of unsuccessful invasion is quite high. Besides, as Pradhan and others have shown, successful globalization requires more than merely significant liberalization: it also requires large and

growing investment in infrastructure, financial intermediation, education, and country branding ---all if-fy prerequisites in resource-poor and debt-dependent Bangladesh.

It is really moot if some of the *failures* cited in the foregoing are about to kick-off *comparative de-industrialization* in Bangladesh of a kind that will hurt SMEs.

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^[1] It is also true of course that some entrepreneurs have also floundered on the alter of setting up domestic firms oriented towards exports. Both refer to intrinsically difficult problems. However, domestic SMEs seeking to make a living off domestically producing *manufactures* for domestic sales have met up with potentially withering competition. Unless something is done to stanch this growing malaise, this could well become an epidemic, with clear implications for social harmony and political continuity.

^[2] *The Taskforce contacted Ms Lisa Daniel in an effort to explore whether it might be possible for results to be made available separately for SMEs and for the “micro”---the other subsector. DFID has finally pointed the database to the Taskforce: it is on the cards now that the Taskforce will make albeit limited use of this database. In fairness, though, “small” on our own definition include both “micro” and “small” enterprises.*

^[3] A portlet is a section of a portal---essentially a large Web site---that parlays *specialized content* to viewers: many portlet can be integrated to yield a complete portal as a content-delivery platform, such as Yahoo! or MSN, for example. Knowlets are knowledge-capsules that can assist in disseminating or mining or archiving knowledge. Using ICTs as a hand-maiden of fostering technopreneurship effectively would no doubt enjoy the earliest start among technologically demanding boosters on our selection, such as electronics, software/ information technology enabled services (ITES), and educational services.

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