Micro, Small and Medium Enterprises in Bangladesh: Are They Scaling Up?
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In the Sixth Five Year Plan (6th FYP) acceleration of GDP growth (from 6.1 per cent in FY 2010 to 8.0 per cent in FY2015) has been targeted through excelling the performance of industrial sector, particularly of the manufacturing sector. The growth of the manufacturing sector will have to be attained through improvement of existing enterprises and also by creating new ones. However, an overwhelming number of these enterprises are micro (having less than 10 workers), small (10-49 workers) and medium (50-99 workers) enterprises, usually called MSMEs/SMEs. Most importantly, their performances are not outstanding in terms of revenue earnings, machinery use, capital-labour ratio and growth of value added except labour-productivity in some instances (SME Foundation Survey, 2006-07). This raises the question, are MSMEs/SMEs scaling up over time? Or, do they emerge, operate and finally extinct after a short life cycle?

Horizontal Expansion of MSMEs: The nature and growth of MSMEs over the last two decades indicate a horizontal expansion of enterprises in terms of increasing the number of establishments without major change in the pyramid-like structure. In 1986, total number of enterprises was 2.6 million of which 2.5 million were micro-enterprises (98 per cent); whereas small and medium enterprises were 49,000 (1.9 per cent) and large enterprises were 2300 (0.08 per cent). In 2002, the structure and composition of enterprises were remained almost the same - out of 3.5 million enterprises, 97 per cent were micro, 2.2 per cent were SMEs and 0.16 were large enterprises. With similar establishment structure, how these enterprises have catered the need of the consumers even after two decades raises number of issues and concerns especially when consumers' livelihood expenditure has substantially increased over this period (per capita GDP in US$ increased by about 47 per cent). The insignificant rise of share of SMEs in the GDP (from 4.0 per cent of GDP in 1986 to 5.2 per cent of GDP in 2010) portrays their limited role in catering the growing need with regard to supply, quality and standard.

Insignificant Scaling-up: It is unclear how much of SMEs have scaled up over the years and have been graduated to the next level from their existing micro, small and medium level. Between 1986 and 2002, number of micro-enterprises has increased at a yearly rate of 57,600; at the same time, number of small and medium enterprises increased by 1,900 and large enterprises by 200. Even if one per cent micro-enterprises scaled up during late 1980s and 1990s, it would create about 9,200 additional small enterprises. Given the rise in number of SMEs between 1986 and 2002 (30,500), incidences of scaling-up appears to be marginal.

Lack of Interdependence between Different Categories of Firms: In the production chain, different categories of firms have their specific roles in complex but linked network. The growth dynamics of different categories of enterprises in Bangladesh rather reflect limited scopes for such interdependence between different categories of firms. Growth of number of large scale enterprises including manufacturing, trade, financial services and other services between 1986 and 2006 was 147 per cent, 103 per cent, 175 per cent and 456 per cent respectively. These high growths perhaps associated with their limited number of establishments. In contrast growth of number of SMEs of the same kinds of

enterprises in the same comparable period was 71.9 per cent, -3.3 per cent, 47.1 per cent and 112.1 per cent respectively. Thus growth of enterprises of different sizes did not have specific trend. Because of differences in target markets (domestic vs. export-oriented), level of competitiveness (local vs. global markets, local products vs. imported products) and level of potentials for expansion etc, growth of different size enterprises was not similar. In other words, this indicates rather a limited level of interdependence between large, medium and small enterprises. More importantly, considerable growth of large enterprises seems to have limited spill-over effect to the growth in medium, small and micro enterprises.

Spatial Difference Affect Scaling-up: The spatial differences between different categories of enterprises signify how and to what extent these enterprises would be able to scale up over time. The overwhelming share of large enterprises located in urban areas (88 per cent of total large enterprises) implies availability of favourable environment for scaling-up of enterprises. Given the huge number of small and medium enterprises located in rural areas (30,290 according to SME Foundation Survey, 2006/07), scaling-up of these enterprises perhaps faced a number of constraints including structural constraints and lack of favourable environment. Then the natural question is what is the ultimate fate of these enterprises – do they extinct after a certain period? If not, how do they cope up over time? Or, how do they compete with imported products or products with urban-origin?

Wide Gap in Required Level of Capital for Scaling Up: There are threshold levels for different sizes of firms in terms of use of number of machines and workers which indicate how much investment to be required for scaling up of existing enterprises. The minimum threshold level in terms of number of machines and workers according to *Industrial Policy 2010* or *SME Policy 2005* found to be different compared to what is found at operational level (based on average number of machines and workers used in different categories of industries). The average number of machines used in small and medium enterprises, according to the SME Foundation Survey 2006-07, was found to be rather close. In contrast, the number of machines used in large enterprises was much higher compared to that in medium enterprises. Thus small enterprises with consistent level of investment for scaling up though found it somewhat attainable to upgrade into medium scale one at a manageable period; but that would rather difficult for medium enterprises to become large scale one within a specific period.

Constraints of Capital for Scaling-up Operation: The sources of investment in fact create a major constraint for small enterprises to undertake any such attempts. In Bangladesh, three-fourth of capital required for small firms are to be generated through retained earnings, while in other countries the ratio were much lower (Ecuador 46 per cent; Philippines 58 per cent and Brazil 59 per cent). However, there are countries with much higher ratio (Azerbaijan and Turkey etc.). Given the limited retained earnings of small enterprises (for example, return on capital: 19.0 per cent for small and 8.4 per cent for medium), it would take about 15 years for a small enterprise to be at a stage of having capital similar to that in large enterprises (provided that growth and level of inflation remained the same). If inflation and growth are to be considered, the period of accumulation of such capital would be much longer for SMEs. Using working capital/project loan from banks and other financial institutions is found to be rather costlier for MSMEs given the high rate of interest charged against industrial loans. Thus, small enterprises usually find it costlier to scale up their operation at their desired level. Overall, small and

medium enterprises did not find sufficient financial resources with favourable terms and conditions for scaling up their enterprises, which make the process of such expansion rather slow.

Limited Examples of Long Life of Enterprises: A long length of operation of enterprises increases the possibility for scaling up of existing enterprises. Analysis of length of operation of firms reflects that most of the firms in different categories operate on an average for a period of 9 years to 15 years. However there are some sectors (e.g. RMG, agro-processing, medical/optical equipments, transport sector and paper-based goods) where average length of operation of large firms is found to be significantly high compared to that in medium/small firms. One possibility could be - this would happen due to gradual scaling up of number of firms from small scale to medium and large one. A number of factors perhaps influence in these situation such as favourable market conditions both domestic and export markets, availability of raw materials and preferential market access. On the other hand, there are some sectors where average length of operation of firms is relatively long for small enterprises compared to that in large enterprises. This might be the case because of specialisation in small scale operations.

Limited Scope for Intergenerational Transfer: Intergenerational transfer of technology and know-how is largely limited in Bangladesh. Most enterprises are owned and operated by first generation entrepreneurs, who have struggled much to sustain their businesses. Average years of schooling of these entrepreneurs in most instances were SSC or HSC levels; and the difference in academic attainment of entrepreneurs between large, medium and small enterprises are not so different. Under the existing structure, availability of capital, skill, knowledge, network and strategies are considered to be more important for scaling up of enterprises. In this context, the most important aspect for scaling up would be how these entrepreneurs consider transferring know-how, technology, knowledge of networking and business techniques to their next generation. The issue is also linked with whether the next generation is ready to take up the family businesses and would take initiatives to expand and graduate them further. While such examples are often observed in case of large entrepreneurs, where they groom up their next generation with higher academic attainment, training and hands-on exercises at their own enterprises, but not much of such incidences are evinced in case of small entrepreneurs for their next generations. Given various constraints small enterprises usually would not capitalize their entrepreneurs' long length of operations through transferring technology and know-how to a better equipped generation. This would be another factor for slow pace of scaling up of operation of small and medium enterprises.

Need Proper Implementation of Existing Policies and Refocusing of Some Policies: In order to ensure better contribution of SMEs, existing policies related to SMEs (*SME Policy 2005, Industrial Policy 2010* and *ICT Policy 2009*) need to be utilized sufficiently. At the same time, medium to long term policies such as *6th FYP, Ten Year Perspective Plan (TFYP)* should be applied keeping in mind towards creating scopes for up scaling and graduating micro, small and medium enterprises. The strategies set forth in the 6th FYP need to be catered towards that end. This include: a) accept SMEs as an indispensable player in growth acceleration; b) re-orient the existing fiscal and regulatory framework; c) create innovative arrangements for small enterprises with desired entrepreneurial track records by offering special financial incentives; d) harness ICT, internet protocol based infrastructure and electronic governance; e)

better credit accessibility, low interest credit facility, proper targeting of enterprises in terms of inputs, outputs, technology and management, issuing ID for SMEs; f) detailed upazilla level map for small and micro enterprises to identify cluster, better financial products for different categories of enterprises; capacity building of financial institutions to provide credit to SMEs; and g) tax holiday and other tax incentives for enterprises etc. All stakeholders including ministries, departments, associations and trade bodies should set time-specific action plan with specific responsibilities. Overall, development of MSMEs should promote 'vertical expansion' of enterprises along with existing strategies for 'horizontal expansion'.

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