

Dynamising Rural Enterprises in Bangladesh

Access to Finance is the Key



Bangladesh Bank

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Executive Summary

One of the biggest barriers to the survival and expansion of rural CMSMEs in Bangladesh is limited access to finance. The study identifies three major issues facing rural CMSMEs in Bangladesh: (i) low and inadequate availability of finance along with high lending rates; (ii) stringent collateral and guarantee requirements for loans; and (iii) convoluted loan application processes. In view of high transaction and processing costs, financial institutions typically view rural CMSMEs as a ‘hazardous’ lending category. As a result, they charge rural CMSME borrowers high interest rates and need collateral and guarantees to reduce credit risks. Because of excessive documentation requirements, the screening procedure also takes a long time.

In Bangladesh, 68 per cent of the population lives in the rural areas and the country’s development largely depends on raising the standard of living of the rural masses and overall progress of the rural economy. In the national economy, the rural CMSMEs play an important role in generating employment, creating wealth and prosperity, and alleviating poverty. The country’s development agenda recognises the critical role that rural entrepreneurship can play through enhancing economic value to the rural nonfarm economy by creating new methods of production through innovation and new technologies, producing new products and services, expanding value chains and new markets, and accelerating a unique blend of growth opportunities for agricultural activities.

Although Bangladesh’s greater growth potential lies in the emerging high-tech industries, but the unexplored potential of the conventional labour-intensive rural CMSME sector is also important to realise the desired diversification and balanced, inclusive and sustainable development of the country to achieve its long term vision of emerging as smart and high income country.

The CMSMEs, rural CMSMEs in particular, are disproportionately hampered by a lack of funding. However, if funding is available, they can benefit from a greater growth boost in all respects than larger enterprises. The current study also demonstrates that rural CMSMEs are more negatively impacted by financing barriers, in addition to reporting many nonfinancial constraints. This may be partially because lack of financing prevents the rural CMSMEs from utilising economies of scale, and in most cases these do not have other alternative funding options. Production technologies usually follow a step-function, and rural CMSMEs require credit in order to advance to the next advanced stage, such as switching from manual to modern technologies.

The present study demonstrates that the access to finance gap for the rural entrepreneurs is a complex problem driven by several factors including lower returns, higher risk perceptions, an uninspiring regulatory environment, and a lack of intermediary skills, experience and capacity. In practice, in Bangladesh: (i) banks/NBFIs do not provide adequate finance to the rural CMSMEs; (ii) these can often earn high returns in their core markets, giving them little reason to take on additional risk in the rural CMSME market; (iii) banks/NBFIs incur higher administrative costs by lending to rural CMSMEs; (iv) banks/NBFIs have difficulties in providing long-term capital; and (v) banks/NBFIs have limited information, skills and regulatory support to engage in rural CMSME lending.

These characteristics of the financial system generate unfavourable lending conditions for rural CMSMEs in Bangladesh. The higher costs, lack of skills and perceived higher risks of investment in rural CMSMEs translate into high interest rates and collateral requirements for the rural entrepreneurs. Additionally, posting collateral is made more difficult by the fact that the majority of the rural CMSMEs operate in

settings with lax property rights and inadequate contract enforcement, where borrowers frequently lack legal titles to their homes or land and are consequently unable to utilise them as collateral. In these situations, a self-reinforcing market failure further hinders rural CMSME lending, since the absence of rural CMSME lending raises costs and creates unfamiliarity and knowledge gaps, which result in adverse selection, which further raises costs and interest rates and reduces lending.

For the future, it is crucial to assess the optimal timing and balance of various initiatives in the larger portfolio of supportive interventions surrounding rural CMSME financing. The current study proposes a number of interventions covering various financing modes. In order to provide sustainable access to finance to rural CMSMEs, it may also be necessary to undertake a comparative study on cost-effectiveness and related issues of alternative modes of financial interventions that could improve rural finance flows and financial structures. The need is also to concentrate on bolstering property rights and contract laws (e.g., collateral recovery procedures), and those that lessen information asymmetries (e.g., credit bureaus and standardised accounting systems).

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Introduction

Rural Bangladesh, with its overwhelming dominance in terms of population, employment and economic activities, is undoubtedly the major driver of the country's inclusive and sustainable development in the coming decades. In this context, the development of the rural nonfarm sector (e.g. cottage, micro, small, and medium enterprises, or CMSMEs) has a major role to play in increasing rural incomes and creating productive job opportunities. Further, increased exploitation of renewable energy sources to address the climate challenges, and sustainable preservation of the environment and ecology will all contribute to Bangladesh's transformation into a smart, high-income country.

In recent years, Bangladesh has seen a boom in rural entrepreneurship, which represents the impact of ongoing rural transformation under which the rural nonfarm sector is rapidly expanding to meet rural demands and improve living conditions of rural households through creating nonfarm jobs, and changing the traditional face of the rural economy.

The country's rural growth and transformation have been facilitated by the rural entrepreneurs, who represent an ecosystem of risk-takers, capital providers, markets, technology and innovation, and intermediaries.

The fact is that there exists entrepreneurial opportunities at the intersection of markets, traditional homes and enterprises, and both traditional and modern technologies characterised by the entrepreneurial ecosystem in rural Bangladesh.

The challenges faced by the rural entrepreneurs cover a number of dimensions, including knowledge gaps, limited access to finance and technology, lack of skills and human resources, inability to adopt modern management practices, marketing issues, lack of standardisation, inefficiencies in the value chains, and difficulty in surviving competition from larger enterprises. The rural ecosystem also takes into account the fact that growth opportunities are not static and that changing environmental conditions create and alter the value chains due to geographical distance, isolation, and many other social and economic factors.

As such, the issue of revitalising the rural regions through the promotion of entrepreneurship is a high priority in recent development strategies of Bangladesh. Over the decades, rural entrepreneurship has been flourishing in Bangladesh which symbolises rural transformation and caters to the rural needs, such as nonfarm employment and better living standards, rural development and curbing rural–urban migration.

In Bangladesh's rural areas, entrepreneurship is essential for fostering innovation, preserving and growing the rural ecology, creating jobs, and regulating the interplay between farming, land use, resource allocations, redirecting rural growth patterns, and promoting inclusive and sustainable social and community development.

It is evident that future national development and shared prosperity, as well as the inclusive development of the rural economy itself, will significantly be impacted by the government's ability to successfully expand rural entrepreneurial opportunities and address the constraints facing the rural CMSME entrepreneurs.

Rural Entrepreneurs in Bangladesh

The spirit of rural entrepreneurship in Bangladesh can be interpreted as a type of individual pursuit that seeks to avail opportunities and establishes new businesses that contribute to the expansion and structural transformation of the rural economy. In rural areas, entrepreneurs play distinct roles at various stages of enterprise development.

In this respect, identifying the specific roles of entrepreneurship and business development in Bangladesh's rural economy is critical since the rural economy has seen substantial shifts away from the agriculture sector but is still at a relatively low stage in the nonfarm activity value chain, has a small manufacturing base, and is dominated by service industries that employ the majority of its relatively low-skilled self-employed workforce.

At the present stage of the country's development journey -- when the agriculture sector is reducing its share of labour absorption and the nonfarm sector (NFS) is absorbing more labour through both self- and wage employment in the industry and services sectors -- the process highlights the need to strengthen the intricate relationships between entrepreneurship and development.

Rural entrepreneurs' innovativeness, adaptability, creativity, efficiency, and location specific advantages can all contribute to their success in numerous ways. Through ensuring responsible customer behaviour, long-term financial access, government support, and community involvement, rural CMSMEs can become a significant contributor to the country's overall economic development.

The expansion of productive job opportunities, particularly in the manufacturing and tradable

Most of these enterprises are characterised by keeping their assets, income, or workforce below predetermined levels. In many ways, their success can be attributed to their innovativeness, adaptability, originality, efficiency, and location specific advantages. Further, these can prosper only through responsible customer behaviour, sustainable financing, government support, and community involvement, these rural CMSMEs can become a significant contributor to the country's rural economy.

services sectors, and the transfer of labour from low-skilled and low-return agriculture and informal activities are widely regarded as important means of attaining inclusive rural development in Bangladesh. In this regard, rural CMSMEs must have sufficient access to a variety of financial and other services in order to sustain and scale-up the enterprises and promote inclusive rural growth.

According to available estimates, rural CMSMEs employ around 80 per cent of the nonfarm labour force and account for about 50 per cent of the nation's nonagricultural output. The opportunities and difficulties faced by rural CMSMEs in Bangladesh differ significantly from those faced by large enterprises.

According to the 2013 Economic Census, all businesses are divided into five classes: large, medium, small, micro, and cottage. These classifications are based on the number of employees or the value (replacement cost) of fixed assets, excluding land and buildings, with distinct standards for the industry and services sectors.

The National Industrial Policy (NIP) 2016, which defines CMSMEs based on fixed assets and number of employees, serves as the current definition of CMSMEs in Bangladesh. This concept has also been used in the SME Policy 2019. However, there still exist some differences in the case of trading enterprises since these are not covered by the NIP or the SME Policy.

Emerging Pattern and Growth Potential

A large informal economy and small-scale production units (cottage, micro, and small enterprises, or CMSEs) have historically dominated the rural economy of Bangladesh. In practice, smaller enterprises especially in rural areas are more susceptible to the issues of bad governance, inadequate regulations, weak institutions and other adverse external factors due to their limited scale. They are also more negatively impacted by high bureaucratic costs than the larger enterprises.

Additionally, their operation in the informal sector severely limits the rural CMSEs' ability to scale-up through limiting their access to financial and other resources, ability to use public services, enter into contracts, access investments and technologies, and develop value chains and market linkages.

Due to their smaller sizes, rural CMSEs are more susceptible to various external issues including, among others, poor governance, inadequate rules and procedures, and weak institutions. These are also more negatively impacted by high bureaucratic hassles than larger enterprises.

From the conceptual point of view, these quantitative size-related factors also affect the organisational behaviour of rural entrepreneurs, despite the fact that the definition of CMSEs in Bangladesh relies on quantitative criteria like employment and/or capital and sales turnover. These traits, among others, include: a lesser ability to shape or control relationships with various aspects of the external environment (such as customers, suppliers, labour market, and sources of finance) compared with larger ones; and a coalescence of ownership and management, which is frequently linked to distinct types of organisational behaviour. Independent ownership can also result in a more limited internal resource base, particularly in the areas of finance and management. Even though these are well acknowledged traits of rural CMSEs, it is crucial to highlight the sector's diversity, particularly when considering the Bangladeshi economy.

According to the 2013 BBS Economic Census, Bangladesh's total number of economic units has grown from 2.17 million in 1986 to 7.82 million in 2013, virtually quadrupling in just 27 years. Of them, 72 per cent were permanent establishments in 1986; however, by 2013, this percentage had dropped to 58 per cent. The change illustrates two new trends: first, growing percentage of temporary establishments and household economic units, which primarily engage in informal activities, indicates that the informal sector is growing fast, offering additional sources of household incomes and jobs, particularly for the impoverished in rural and urban areas; and second, the steady rise in permanent establishments is broadening the nonfarm (and diverse) economic base, initiating the formalisation of economic activities. Additionally, there is a definite positive correlation between formal employment and educational achievement; those with higher levels of education are more likely to work in the formal sector.

Nonetheless, in the context of rural entrepreneurship, it is crucial to distinguish between ‘proprietorship’—the ownership of cottage and micro enterprises (CMEs) that can be used to realise profits to supplement household incomes but are not usually utilised for the longer-term processes of capital accumulation—and ‘entrepreneurship’, which refers to an individual's dedication to capital accumulation, scale-up and business growth, when advocating for the role of CMSEs in entrepreneurial transformation and CMSME growth.

In actuality, Bangladeshi rural CME proprietors are more likely to spend the additional income to meet household consumption rather than to put it back into their enterprise growth. Since they primarily work to protect themselves by producing cash flows that can be used to raise general living standards rather than for business expansion, one could argue that ‘proprietors’ rather than ‘entrepreneurs’ control the majority of smaller enterprises that have been established in Bangladesh.

Therefore, it is likely that only a small percentage of rural CMSE owners qualify as ‘entrepreneurs’ in the traditional sense. It is important to realise that not all rural CMSE owners want to scale-up their enterprises, and that rural CMSE development in Bangladesh is more than just an economic endeavour. As the country's economy continues to undergo fast changes, a distinct class of small entrepreneurs is emerging as part of the social transformation process, which also contributes to the rise of the middle class and creating more options for the consumers. As a result, rural CMSEs' roles will need to adapt to the various phases of this transition process.

As the middle class becomes more influential and its income levels rise, consumer marketplaces will become more distinct and fragmented, reflecting shifting consumer demand trends. In rural CMSEs, this will lead to new business prospects and the development of new types of jobs. Additionally, this will increase the opportunities for self-employment. Finding the precise rural CMSEs with the potential to create jobs and figuring out how to realise that potential is a significant challenge in this regard. Since most rural CMSEs develop in the first few years after starting up and subsequently stabilise, it is generally believed that younger businesses tend to produce more jobs than older ones. In a similar vein, the smallest new businesses typically expand more quickly than the others.

Therefore, it seems that concentrating on enterprises with the biggest growth potential is the best strategy to create new jobs in rural areas over the long run. Policymakers need to acknowledge that job growth is the result of rapid output growth, even though entrepreneurs' growth aspirations are usually more defined in terms of sales or profits than in terms of employment.

Rural CMSEs have additional features that are advantageous from an economic standpoint. One feature of CMSE owners is their educational backgrounds: around 86 per cent of rural enterprise owners have degrees from universities. Education tends to impact management behaviour, including a stronger propensity to adopt technology in managing and developing the enterprises, even while it is not a guarantee of economic success. They are better able to pinpoint management weaknesses, especially in sales and management, and improve the enterprise's managerial capabilities. The competitiveness of rural CMSEs can undoubtedly be raised by having access to an efficient system of management training and business support.

Characteristics of rural enterprises

The number and type of economic enterprises and employed labour in Bangladesh can be seen in Table 1. It shows that out of a total of 7.82 million enterprises in 2013, more than 71 per cent (5.59 million) are

rural enterprises while the rest 29 per cent are located in the urban areas. Of the total enterprises, nearly 89 per cent (6.95 million) are cottage and micro enterprises (CMEs) while about 11 per cent (0.87 million) belong to small and medium enterprises (SMEs). The number of large enterprises is only about six thousand. In the rural areas, nearly 93 per cent of all enterprises are CMEs and about 7 per cent are SMEs with only about two thousand large enterprises. Similarly, in the urban areas, the employment structure is also skewed with CMEs accounting for 66 per cent and SMEs for 26 per cent of total persons employed. The remaining 8 per cent are employed in large enterprises. Thus, it is evident that Bangladesh's rural entrepreneurs are characterised by extreme dualism with significant imbalances in the overall size structure of enterprises. This suggests that a dualistic strategy is required to address the limitations that rural entrepreneurs face, such as their inability to access and utilise financial services, undertake innovations, upgrade existing technologies, and implement business development and marketing strategies.

Table 1: Number and types of enterprises and employed labour in Bangladesh, 2013

Enterprises/persons employed	Rural	Urban	Total
Type of enterprises			
	Number in million		
Cottage	5.11	1.73	6.84
Micro	0.07	0.04	0.11
Total CMEs	5.18	1.77	6.95
Small	0.41	0.45	0.86
Medium	0.003	0.004	0.007
Total SMEs	0.413	0.454	0.867
Large	0.002	0.004	0.006
All enterprises	5.585 (71.4%)	2.228 (28.6%)	7.823 (100%)
Persons employed			
	Number in million		
Cottage	9.56	3.61	13.17
Micro	0.34	0.22	0.56
Total CMEs	9.90	3.83	13.73
Small	3.53	3.07	6.60
Medium	0.37	0.34	0.71
Total SMEs	3.90	3.41	7.31
Large	1.20	2.26	3.46
All enterprises	15.00	9.50	24.50

Source: Economic Census 2013, BBS 2015

- Several aspects of the country's rural enterprise sector are highlighted in the 2013 Economic Census results:
- There are about 0.87 million manufacturing enterprises, or only 11 per cent of all enterprises; the other enterprises are service-oriented. Nonetheless, manufacturing accounts for roughly 29 per cent of all jobs across all enterprises.
 - Nearly 72 per cent of all economic enterprises and 76 per cent of manufacturing enterprises are located in rural areas, demonstrating the dominance of rural areas in nonfarm enterprises.
 - Cottage enterprises make up over 88 per cent of all enterprises, whereas micro, small, and medium enterprises (MSMEs) make up only 12 per cent and large enterprises make up only a few thousands.
- However, cottage enterprises are less common in the manufacturing sector, making for only 28.8 per cent of manufacturing employment as opposed to 83.8 per cent for all enterprises. Manufacturing MSMEs, on the other hand, make up 30.6 per cent of manufacturing jobs and 15.9 per cent of total enterprises.
- However, in terms of employment, cottage enterprises are much less prevalent. Cottage enterprises make up 53.7 per cent of the total, followed by MSMEs (32.1 per cent) and large businesses (14.1 per cent).

The size category "10 workers" accounts for approximately 98 per cent of all nonfarm enterprises, which is another significant characteristic. Additionally, according to the 2013 Census, nearly 95 per cent of Bangladesh's manufacturing enterprises employ fewer than ten people.

As per the preliminary report of the 2019 Survey of Manufacturing Industries (SMI) of BBS, estimated value addition of manufacturing MSMEs is Tk. 1,228.96 billion, which is about 26 per cent of total manufacturing value added in the year. The share of manufacturing MSMEs in the country's GDP for the fiscal year 2018-19 is thus around 4.9 per cent.

All things considered, Bangladesh's CMSMEs serve as an illustration of enterprises that are centred around entrepreneurship and are typically constructed using tried-and-true, creative, and practical methods. Because of this, these may endure and even thrive under the most difficult socioeconomic conditions.

The models that the rural CMSMEs typically use are profitable, market-responsive, and require little capital. They have the potential to become 'silent transformers' of the Bangladesh economy because of their sheer numbers and comparatively straightforward business models that align with the characteristics of the existing labour force and resource endowments of the rural economy. As a result, even though they are small, CMSMEs contribute significantly to the nation's employment, output, and earnings.

The above analysis shows that the cut-off lines separating the CMEs from the SMEs are important for Bangladesh as the former typically operates in the informal sector without registering their status and whether or not these enterprises are included can significantly affect the size structure of enterprises, associated challenges, and the policy implications.

Constraints to Rural Entrepreneurship Development

Due to inadequate infrastructure and a lack of market knowledge, rural enterprise owners—particularly CMSE owners—frequently struggle to sell their produce to the right customers at the right time in the desired amount and quality. As a result, they must deal with low prices and high transaction expenses.

Additionally, the majority of the rural enterprise owners run cottage and micro enterprises (CMEs), which are smaller and lack access to information and technologies outside of their immediate surroundings, which limits their ability to innovate. It might be challenging for these CMEs to scale up their operations and slow down the growing process because they typically have low profit margins.

Policy environment

Although the laws and regulations of the formal financial system typically do not apply to rural CMSMEs, especially CMEs, these restrictions can seriously limit their ability to grow and integrate into the mainstream economy. Bangladesh's economic reforms have created fresh prospects for the sector's expansion and for the establishment of long-lasting institutions to support it. To level the playing field for the country's smallest economic activity, however, regulatory adjustments are still a way off. To enable the growth and sustainability of rural entrepreneurial services and enhance the environment for CMSME development, some issues still need to be resolved, including better business regulations, tax regimes and licensing requirements, and the adaptation of financial sector norms and supervision.

Financial intermediation

Access to credit is recognised as a determinant of rural entrepreneurship because it helps potential entrepreneurs obtain the capital required to start a business. Likewise, relaxing credit constraints helps individuals to switch from wage employment to self-employment e.g. to become entrepreneurs. At the same time, credit constraints are identified not only as hurdles to starting an enterprise but also as potential limitations to an entrepreneur's capacity to grow. Further, financial services are important instruments for mobilising resources for productive use and enable rural entrepreneurs to overcome liquidity constraints and invest to improve performance and competitiveness.

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At present, despite years of special programmes and institutional development, only a small share of rural entrepreneurs has access to formal financial services. However, given their benefits for getting around the informational barriers to formal lending, informal moneylending operations are still a significant source of rural funding and are likely to remain so in the near future. Due to the relatively high cost of issuing small loans and the absence of necessary collateral, formal financial institutions still do not reach the majority of rural entrepreneurs using their traditional lending technology.

As a result, the majority of the enterprises are self-financed in Bangladesh. This is true for rural enterprises as well. Sometimes enterprises require external financial support for scaling up the business. Bank financing has always been a constraint to the development of rural enterprises in Bangladesh. According to available information, the main obstacles that rural entrepreneurs face are: lack of modern technology; high interest rate on bank loans; irregular or inadequate power supply; poor physical infrastructure and high transportation costs; lack of information about market opportunities and requirements; lack of skilled technicians and workers; lack of research and development facilities; intense competition; lack of an efficient and transparent legal system; difficulties in accessing technology; credit constraints; lack of access to business development services; lack of human resource quality; low awareness; lack of lobbying capacity; and rapid changes in the policy environment.

Business development and nonfinancial services

Nonfinancial services like marketing, instructions in fundamental business skills like bookkeeping, and technology transfer are not readily available to entrepreneurs in the rural areas. Furthermore, many rural areas are relatively underdeveloped and have difficult terrains along with lack of transportation and communication facilities. The long-term viability of business development services (BDS) offered by the public sector has been constrained by their heavy reliance on grant funding. Because of this, rural entrepreneurs typically receive training and other BDS that are of poor quality and in low demand. Furthermore, it is more expensive to supply services to rural entrepreneurs due to their lack of organisation.

Recent Policies for CMSME Development

The Ministry of Industries, Bangladesh Small and Cottage Industries Corporation (BSCIC), SME Foundation, and Bangladesh Bank are the main participants in the multi-institutional support system for CMSME development that is now in place. There are notable commonalities even though they all operate in different fields. The SME Foundation, for instance, was intended to be a "one stop service" provider, but it lacks the legal capacity to regulate pertinent organisations. Despite having collected data on SME clusters, their makeup, and their credit requirements, the Foundation does not participate in Bangladesh Bank's credit programmes.

The Bangladesh Bank offers a number of initiatives to provide institutional financial services to CMSMEs, including credit wholesaling, establishment of CMSME service centres and dedicated desks within the banks, and initiatives tailored to women entrepreneurs. The Bangladesh Bank established the SME and Special Programs Department (SMESPD) to design policies, facilitate loans, and track the growth of CMSME entrepreneurship. The Bangladesh Bank's credit wholesale programme includes refinancing small enterprises through 46 banks and non-bank financial institutions, as well as refinancing programmes for women entrepreneurs, new enterprise owners, and cottage, micro, and small enterprise owners.

Box 1: Some measures adopted by Bangladesh Bank for SME development

Bangladesh Bank has implemented a number of programmes and initiatives to support the growth and development of CMSMEs in the country. For the growth of the CMSME sector, a refinance programme supported by Bangladesh Bank, IDA, and ADB has been undertaken. Additionally, Bangladesh Bank has adopted a number of actions to guarantee institutional financial facilities under favourable conditions, such as establishing "Dedicated Desks" for CMSMEs and "SME Service Centres" in the banks and providing specific amenities for women entrepreneurs. However, the truth is that this sector has yet to produce the anticipated results.

Given the recent global recession and altered conditions, it is now crucial to involve all facets of society in the process of growth by granting credit to enterprises that have received less attention because of current market mechanisms, particularly the agriculture and CMSME sectors especially in the rural areas. Bangladesh Bank has created a new division named as the "SME and Special Programs Department" (SMESPD), which is exclusively in charge of developing policies, providing funding, overseeing, and fostering entrepreneurship in the CMSME sector. The following are some significant guidelines developed by SMESPD to ensure banks and other financial institutions comply with the development of the CMSME sector:

- Considering SME development as one of the nation's top development priorities, banks and other financial institutions have been setting indicative objectives for SME loan disbursement since 2010. The aim is that small, medium, and female entrepreneurs will receive SME loans.
- The 'Area Approach Method' will be used by banks and other financial institutions to divide their indicative aims into three categories: sector, region, and branch.
- To achieve a simple and quick loan sanction and disbursement process, each bank or financial institution must finance SME loans using a unique business plan and minimal formalities in documentation execution.
- Small business owners will be given priority.
- The credit ceiling for small business owners would be between Tk 50,000 (fifty thousand) and Tk 5,000,000 (five million).
- Priority will be given to prospective women entrepreneurs when it comes to SME credit disbursement in order to increase the number of women entrepreneurs conducting business and their involvement in the nation's industrial growth.
- When small and medium-sized female entrepreneurs apply for loans, banks and other financial institutions will give them top priority and complete the loan disbursement process as quickly as possible after the application is accepted.
- Every bank and financial institution must set up a distinct "Women Entrepreneurs' Dedicated Desk" with the required and appropriate staff, train them on financing SMEs, and choose a suitable female officer to serve as the desk's chief. The SMESPD of Bangladesh Bank should receive a branch-by-branch list of the "Women Entrepreneurs' Dedicated Desk" within two months of the policy and program's announcement.
- Under personal guarantee, banks and other financial institutions can approve up to Tk 2,500,000 for female entrepreneurs. Social security or group security may be taken into consideration in the situation.
- The effectiveness of SME loan disbursements will serve as a benchmark for approving additional branches of the relevant bank. In order to include banks in funding key areas including SMEs and agriculture, licenses for new branches will be granted starting in 2010 under the designation "SME/Agriculture Branch" rather than "SME Service Center."
- The interest rate for SME loans must be set by each bank or financial institution according to the sector or sub-sector. However, the bank or financial institution will promptly notify Bangladesh Bank of the interest

rate by sector or sub-sector and guarantee that the refinanced funds are disbursed to the clients (women entrepreneurs) at the bank rate plus 5% interest.

- The entrepreneurs will be provided with training programs.

Source: Bangladesh Bank, SME & Special Programmes Department, Small and Medium Enterprise (SME) Credit Policies and Programmes.

Box 2: Bangladesh Bank SME Policy 2022

The Bangladesh Bank SME Policy 2022 aims to support the growth of cottage, micro, small, and medium enterprises (CMSMEs) through increased access to finance and streamlined procedures. It includes measures like a 3-year refinancing scheme of BDT 25,000 crore, digital financing initiatives, and recognising informal enterprises. The policy also focuses on women entrepreneurs, with specific guidelines for loan applications and dedicated support desks in banks. The key features of the Policy cover:

Refinancing Scheme: Establishment of a 3-year BDT 25,000 crore refinancing scheme to provide concessional financing to CMSMEs.

Digital Financing and AI: Emphasis on digital financing and use of artificial intelligence (AI) in SME lending.

Informal Sector Inclusion: Formal recognition of informal enterprises for the first time in the Policy.

Expansion of Loan Limits: Enhancement of investment and credit limits, particularly for services and trading sectors.

Revised Definitions: Adoption of redefinition of service industries in line with the National Industrial Policy 2022 and the Bangladesh Bank's CIB Batch Contribution User Guide.

Women Entrepreneur Support: Utilisation of specific guidelines to prioritise women entrepreneurs, including dedicated support desks in banks and simplified loan application forms.

Cluster Development: Encouragement for the development of SME clusters, particularly those run by women entrepreneurs.

Credit Guarantee: Adoption of supportive legislation like the provision of credit guarantees by the Credit Guarantee Department (CGD) for collateral-free or partially collateralised loans to CMSMEs.

Skill Development: Emphasis on skill development programmes for CMSME entrepreneurs through initiatives like the Skills for Employment Investment Program (SEIP).

The Policy identifies the following Focus Areas:

Increased Access to Finance: The policy aims to address the financing gap faced by SMEs in Bangladesh.

Simplified Procedures: Streamlining loan application processes and reducing documentation requirements.

Capacity Building: Providing training and support to enhance the skills and knowledge of SME entrepreneurs.

Overall, the Bangladesh Bank SME Policy 2022 seeks to create a more supportive and inclusive environment for the growth of the CMSME sector, which is vital for Bangladesh's economic development.

Source: SME and Special Programs Department (SMESPD), Bangladesh Bank.

Some recent evidence, however, suggests that the support system for CMSMEs, especially for rural ones, has not improved much as a result of the adopted changes in institutional procedures. Ensuring proper targeting is still a significant concern, even though the Bangladesh Bank's present institutional structures have encouraged banks and NBFIs to disburse additional credit to the CMSME sector. More efficient cooperation between the Bangladesh Bank and SME Foundation is likely to guarantee more precise

cluster and sectorial targeting of credit for the CMSMEs, since the Foundation has better knowledge base for these enterprises especially those in rural areas.

The growth and development of CMSMEs is a critical element of the government's overall development agenda, according to the National Industrial Policy (NIP) 2016. The primary goals of CMSME development are outlined in the 2016 NIP, along with the policies that need to be implemented to meet these goals. In order to remove policy barriers and neutralise market barriers, the policy guidelines place a strong focus on the government's position as a facilitator. The roles of several organisations, such as the SME Foundation, Bangladesh Bank, and BSCIC, in accomplishing the goals of CMSME growth are also emphasised. The Ministry of Industries (MOI) has also established a Small and Medium Enterprise (SME) Cell to serve as the hub for delivering the required promotional assistance to CMSMEs and to coordinate the efforts of pertinent organisations. Furthermore, the SME Policy 2019 offers comprehensive guidance for the nation's SME development (Box 3).

Box 3: Major thrusts of 2019 SME policy and SME policy 2022

The 2019 SME Policy identifies six pillars for successful initiatives: (i) financial accessibility; (ii) innovation and technology accessibility; (iii) market accessibility; (iv) education and training accessibility; (v) business support services accessibility; and (vi) information accessibility. Three pillars are the basis of the development strategies: (1) supportive environment and policies; (2) organisations that are sustainable and successful; and (3) chances to offer financial and business support services to disadvantaged and potential entrepreneurs.

Based on the above, ten strategic goals are also specified:

Strategic Objective 1: Enhance the institutional structure and business climate

Strategic Objective 2: Expand the SME sector's access to institutional investment

Strategic Objective 3: Boost SMEs' capacity for competition and facilitate the launch of SME goods

Strategic Goal 4: SME business support services, assistance with the quick and inexpensive setup of new businesses

Strategic Objective 5: Establishing and growing a business network for SME clusters

Increasing the use of ICT and other technologies is the sixth strategic goal.

Strategic Goal 7: Expanding training and educational initiatives for business owners

Strategic Goal 8: Growth of programs and special services for women entrepreneurs

Strategic Goal 9: Create forward and backward connections between SMEs and major industries, as well as establish criteria for the caliber of SMEs' output.

Strategic Goal 10: Increase SMEs' ability to create eco-friendly businesses and manage industrial waste

The organisations responsible for carrying out strategic objectives and action plans are the BSCIC and SME Foundation. The SME Foundation will adopt an annual strategic action plan and carry it out in coordination with the implementing agencies, while BSCIC will carry out its own strategic action plans in cooperation with other implementing agencies. In addition to providing the required financial and other support, Ministry of Industries will routinely oversee and assess the development and execution of the BSCIC and SME Foundation's action plans and activities. In order to carry out SME development objectives, the BSCIC and SME Foundation would work with pertinent trade associations. In order to hasten the sector's development, they will also establish a productive support environment.

The top policy-making body for carrying out the government's commitment to the sector's development is the National SME Development Council (NSDC). To examine the action plan and determine the priority of the proposed initiatives in the 2019 SME Policy, an executive group known as the SME Task Force has also been established.

The National Industrial Policy 2022 emphasises the crucial role of SMEs in socioeconomic development and

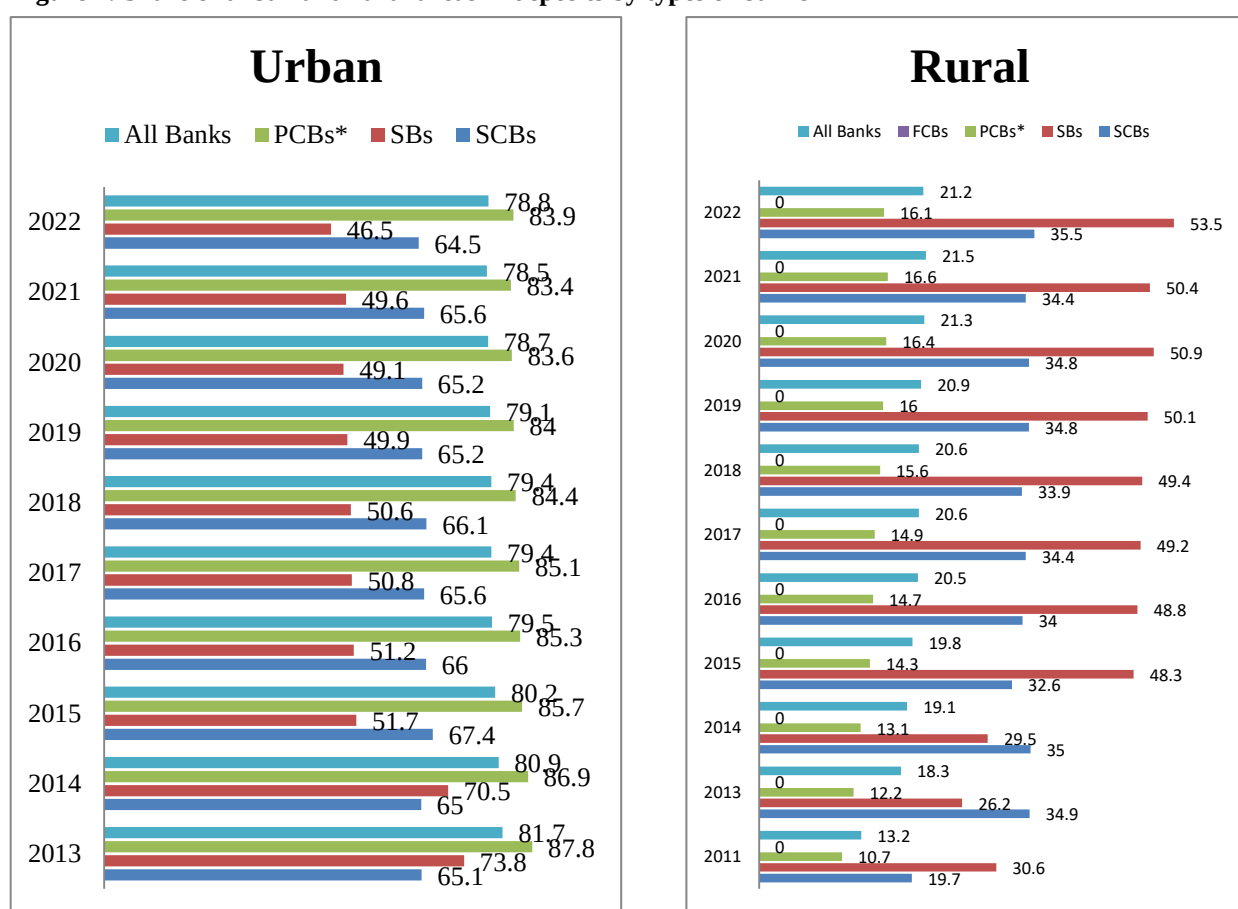
employment generation. The Policy aims to increase the industrial sector's contribution to GDP to 40 per cent, with SMEs expected to play a significant role in reducing inequality. This Policy builds upon previous initiatives like the SME Policy 2019 and supportive legislation such as the Credit Guarantee Department (CGD) established in 2022.

Source: Ministry of Industries, The SMEs Policy 2019, National Industrial Policy 2022

Rural finance mobilisation and access to finance by CMSMEs

Deposit mobilisation efforts in Bangladesh, as in most developing countries, have traditionally been confined to the urban areas, primarily because of the perception that rural people have low incomes and hence do not have much surplus to save. Still, despite some increases in recent years, the share of rural areas in total deposits of all types of banks is around 20 per cent while the rest 80 per cent comes from the urban areas (Figure 1).

Figure 1: Share of urban and rural areas in deposits by types of banks



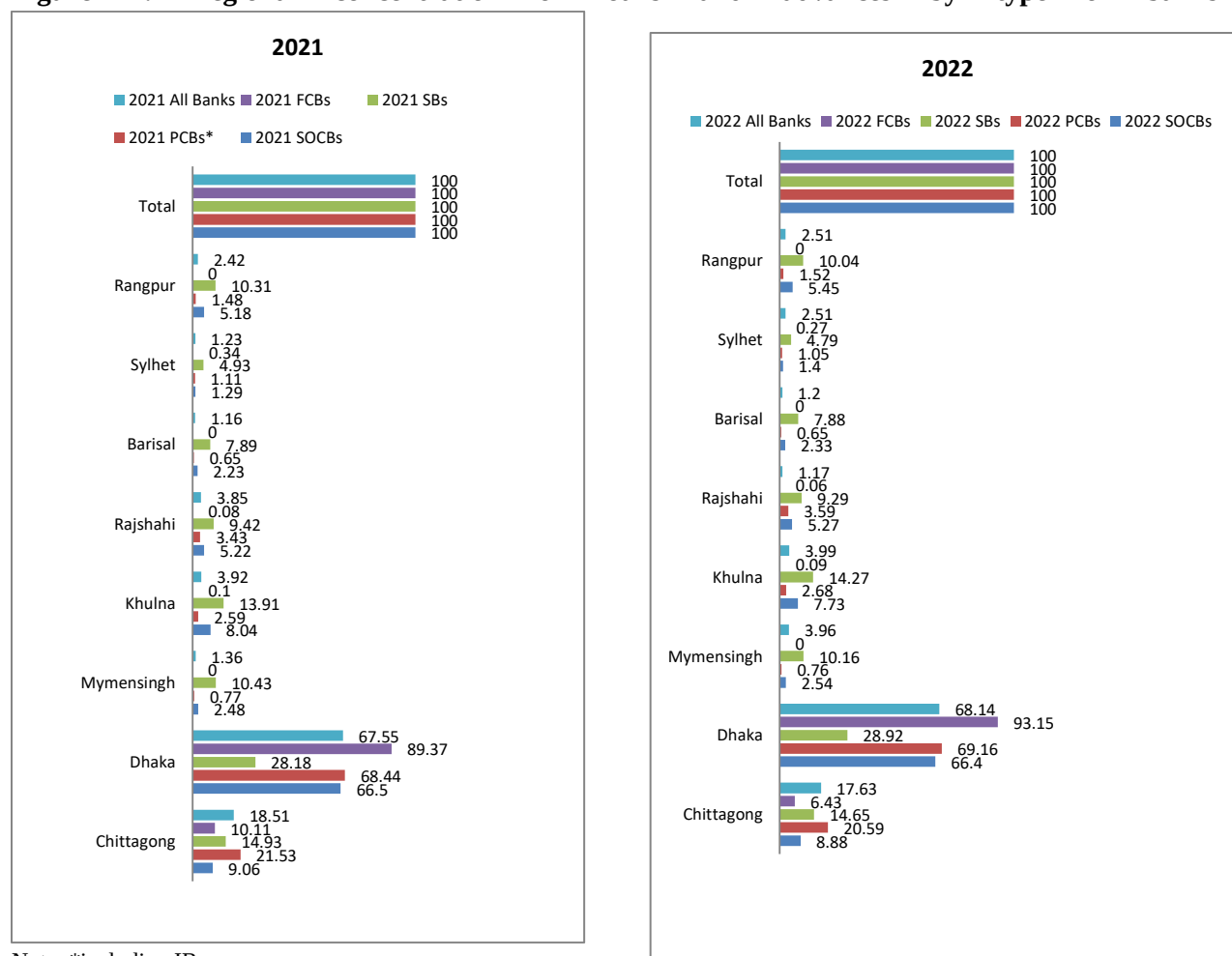
Note: *including IBs

Source: Bangladesh Bank, Scheduled Bank Statistics, various issues.

On spatial and geographical inequalities, it is observed that ‘spatial inequality is a dimension of overall inequality, but it has added significance for rural entrepreneurs. Even a geographically small country like Bangladesh can have significant regional inequalities where a clear East- West divergence is visible. Such disparities can concentrate poverty in certain regions, skew intra-national migration patterns, create the grounds for resource-based and inequality-based tensions and pose threats to achieving the Sustainable Development Goals (SDGs) and promoting inclusive development priorities.

An unequal financial sector (e.g. in terms of distribution of loans and advances) has profound implications for the rest of the economy and an inclusive financial development may provide more opportunities and reduce regional inequalities. Improved access to financial services and products for the households also promotes financial development, contributes to economic growth, reduces income inequality and poverty, and has positive effect on household incomes. In Bangladesh, a significant regional concentration of loans and advances by banks can be observed. For example, loans and advances of all types of banks are highly concentrated in favour of two administrative divisions (Dhaka and Chattogram) of the country: these two divisions received 86 per cent of the total loans and advances by all types of banks in 2021 and 2022 while the rest of the six divisions got only 14 per cent (Figure 2).

Figure 2: Regional concentration of loans and advances by type of banks

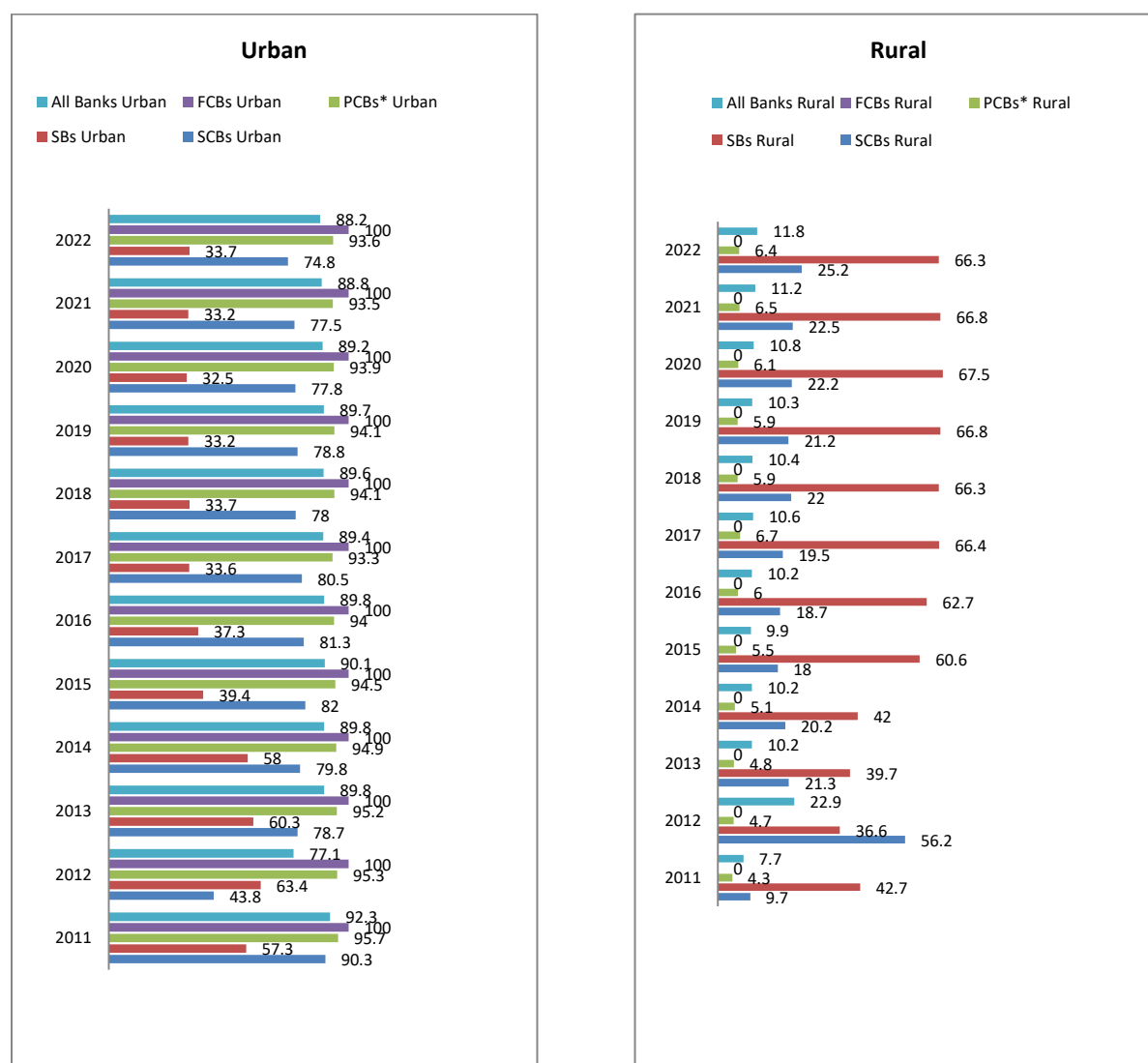


Note: *including IBs

Source: Bangladesh Bank;

However, despite the compulsions and the growing needs to support the complexities of ongoing rural transformation, the present trends in relative priorities of rural and urban enterprises in loan disbursement by various bank categories indicate that the rural enterprises remain disproportionately deprived in loan disbursement by different categories of banks in Bangladesh. Recent statistics indicate that rural enterprises have received only around 10 per cent of the total loan disbursement by all banks while the rest has gone to their urban counterparts (Figure 3).

Figure 3: Relative priorities of rural and urban businesses in loan disbursement by various bank categories (in per cent)



Note: *including IBs

Source: Bangladesh Bank, Scheduled Bank Statistics, various issues.

Obviously, there are both demand and supply side issues to resolve the challenges. Many small rural businesses lack access to the financial resources needed to start and grow their businesses. The banking system rarely has sufficient services and products that meet the rural enterprises' needs, and public supporting schemes often have unreachable criteria for smaller rural enterprises. They may also struggle to access markets for lack of linkages with supply chains with urban and external markets. Additionally, smaller rural enterprises may face challenges related to infrastructure, such as limited access to electricity, transportation, and ICT. These challenges can make it difficult for rural enterprises to operate efficiently, limiting their potential for growth and profitability.

Microfinance institutions (MFIs) have been playing a major role in broadening and deepening financial access for the poor since independence, especially for women entrepreneurs operating informal micro

enterprises. Although MFIs registered under Microcredit Regulatory Authority (MRA), along with the Grameen Bank, are the major players of the microfinance sector, there also exist other government agencies and non-government MFIs. According to the Credit and Development Forum (CDF), total volume of microcredit and microenterprise loans disbursed was BDT 2,091.56 billion (microcredit loan of BDT 1,349.68 billion including other programmes and microenterprise loan of BDT 741.88 billion) in 2021-22 to 35.73 million borrowers of whom 5.35 million are microenterprise borrowers. Moreover, of these microcredit and microenterprise borrowers, 91 per cent are women. Initially, MFIs were entirely dependent on grants and foreign funds to run their operations; however, the sector has now diversified its sources of funding and strives for sustainability. Currently, its major sources of funding are member savings (42 per cent), accumulated surplus (29 per cent) and bank loans (26 per cent) while government support (through PKSf) and donor and other funding have reduced significantly in recent years.

In short, over the last decade, there has been growth and improvement in the financial support available to CMSMEs due to rapid changes in the policy environment. Since 2010, the total volume of loan disbursement to CMSMEs (by banks and NBFIs) has increased more than five times from around BDT 535 billion to more than BDT 2,829 billion in 2022. Moreover, CMSMEs now receive a greater proportion of the overall loans. An analysis of the patterns of CMSME loan distribution shows that during the initial period relatively a greater proportion of loans were provided to the medium enterprises since this sub-segment was considered as less risky by banks and NBFIs but the situation has changed rapidly in later years.

The complex range of interacting constraints as discussed in the preceding sections result in a gap between the financing needs of CMSMEs and the finance they can access in reality. There are several estimates available regarding the CMSME financing gap. The World Bank estimates the CMSME financing gap in Bangladesh at Tk 170 billion in 2019. The SME Finance Forum indicates that the current volume of CMSME finance is 32.7 per cent of total demand in 2020, implying that the formal CMSME finance gap is 67.3 per cent. Moreover, the formal finance gap differs both by firm size and gender. According to the SME Finance Forum, 61 per cent of Bangladeshi women-led CMSMEs are partly or fully constrained in their access to finance, compared with 49 per cent for men-led CMSMEs.

Thus, limited access to finance is one of the top obstacles especially to rural CMSME survival and growth in Bangladesh. Similar to many other developing countries, the three main problems for CMSMEs in Bangladesh are: (i) a high lending rate; (ii) strict collateral and guarantee requirements for loans; and (iii) complicated loan application procedures. Financial institutions generally regard CMSMEs as a risky segment for lending, prompting them to impose high interest rates on CMSME borrowers to cover high transaction costs, and demand collateral and guarantees to mitigate credit risks. The screening process is long because of the extensive documentation required. Accordingly, one can identify several major hurdles for CMSME access to finance in Bangladesh:

- **Inadequate access to formal credit for manufacturing CMSMEs.** Roughly only around 35 per cent of CMSME credit goes to manufacturing, even though manufacturing is the main driver of the Bangladesh economy and nearly 46 per cent of the SMEs (and about 12 per cent of CMEs) belong to this segment. Thus, financing manufacturing CMSME entrepreneurs, including export-oriented enterprises, needs to be strengthened.

- **Limited financial outreach to women CMSME entrepreneurs.** The disbursement of CMSME loans to women entrepreneurs is only about 4-5 per cent of the total. Thus their access to formal credit remains difficult.
- **Limited financial outreach to rural CMSME entrepreneurs.** In general, CMSME loans are provided mostly to urban enterprises, and only around 25 per cent goes to the rural ones. Moreover, CMSME credit is concentrated in the metropolitan areas, especially in the capital city, Dhaka.

Future outlook and new challenges

An important policy priority in Bangladesh is to reform the policies that divide the informal and formal sectors, so as to enable the poor to participate in markets and engage in higher value added business activities. In order to tap into the potential of CMSMEs for development and poverty reduction, Bangladesh needs to address a number of challenges for the future:

- CMSMEs will have to expand and develop through (i) creation of new and innovative enterprises and (ii) graduation of as many informal enterprises as possible into the formal sector.
- CMSMEs will have to become more competitive and productive.
- An increasing share of the competitive CMSMEs will have to achieve a level of competitiveness that will enable them to integrate into the global value chains (GVCs) through trade (exports and internationalisation) and investment, including linkages with FDI.

In these contexts, multiple challenges are faced by Bangladesh. As trade barriers are dismantled and transport and communication costs decline, the CMSMEs are required to add more value to their products to stay ahead and compete with lower cost rivals. Further, consumer demand is changing rapidly as incomes rise and choices increase when imported products become easily available in domestic markets. Technological advances create new products and transform almost every stage of business from production to marketing, sourcing and logistics.

In addition, new rules introduced through the multilateral trade system and foreign buyers would require the CMSMEs to comply with higher technical (e.g. technical barriers to trade), environmental (e.g. ISO14000) and labour standards in domestic and export markets. Multinational enterprises seeking out new markets and investments offer capable CMSMEs the opportunity to insert themselves into the GVCs through subcontracting linkages, while those that are unable to do so increasingly face the danger of losing their existing markets. Competition within the developing world for export markets, foreign investment and resources is also intensifying. Against this backdrop of increased global competition, the government and CMSMEs in Bangladesh will have to adjust and adopt new approaches and invent new ways of working together to foster CMSME competitiveness.

The CMSMEs face challenges in accessing formal finance in the form of bank loans, guarantees, venture capital, leasing and so on. Moreover, due to high-perceived risks in CMSME loans, access to competitive interest rates is also very limited. Finally, banks prefer to lend to the formal sector and the government, which offer less risk and higher returns. However, innovations can be introduced by the banks/NBFIs which can provide good results in servicing the CMSMEs (Box 4).

Box 4: Challenges in access to finance for rural CMSMEs and potential financial innovations

Rural CMSME constraints in access to finance	Banks/NBFIs' potential response to overcome constraints
• Because of their low capitalisation and lack of assets, high mortality rates, and susceptibility to market swings, CMSMEs are viewed as high-risk debtors by creditors and investors. • It is challenging for creditors and investors to evaluate the creditworthiness of CMSMEs due to information asymmetry brought on by CMSMEs' lack of accounting records, insufficient financial statements, or outdated business strategies. • CMSME finance is not an attractive proposition due to high transaction and administrative costs associated with lending or small-scale investments.	• By using credit scoring systems, external information providers, risk self-assessment for CMSME entrepreneurs, pricing according to risk, sharing risk with third parties (loan guarantees), using covenants as an alternative to loan guarantees, and establishing special support units for high-risk clients like start-ups, it is possible to reduce information asymmetry of CMSMEs and high perceived risks. • Lowering loan costs through the use of cutting-edge information technologies, simplifying the lending process, and streamlining the organisational processes. • Creating products that are more tailored to CMSME requirements. • Enhancing financial services for CMSMEs by segmenting CMSME clientele and educating bank employees. • Collaborating and working with MFIs, CMSME organisations, and other business development providers to integrate financial and non-financial services and lower risks and expenses.

Source: Authors' compilation

The rural CMSMEs have the choice to work with venture capital investors in addition to loan financing. Leasing, trade credit, and fiscal incentives in the form of tax cuts could be additional important CMSME financing options. To benefit from trade and investment opportunities and the global trading system, rural CMSMEs will need to be able to react to market signals fast and effectively. Business development services (BDS), among other things, assist rural CMSMEs in putting competitive business practices and plans into action. Training, consulting and advisory services, marketing support, information, technology creation and transfer, and business linkage promotion are a few of the many services that can be included in the BDS. Given the shortcomings of public BDS provision, a market-based approach might be the best course of action. Traditional programmes have been supply-driven, which have pushed out potential private sector BDS providers with free or subsidised services, but have limited outreach, and have been of low quality because of institutional limitations.

The long-term goal for BDS has to be the creation of a thriving market with a wide range of excellent services that reasonably address the demands of rural CMSMEs. The public sector need not be completely excluded from its duties; instead, the strategy would focus on limiting its interventions to the development of private sector BDS markets as 'financiers' of BDS suppliers (which could be either public or private) and BDS facilitators (which can be either private or public).

Sub-sector and BDS market evaluations, which evaluate CMSME demands, future demand for specific BDS, and the health of the BDS market, are among the primary operational aspects of the BDS market-development strategy. As a result, the strategy must create commercial BDS offerings that are more

pertinent and are in demand by rural CMSMEs. Wherever necessary, the strategy could incorporate both supply-side and demand-side measures. For BDS, BDS suppliers, and BDS facilitators, the BDS market development strategy needs to have a number of general attributes.

With increasing globalisation, the potential benefits of FDI to rural CMSMEs in Bangladesh may be realised through five major linkages and spillover effects -- backward interactions with suppliers, forward linkages with clients, rival connections, technology partners, and spillover effects. Improving FDI-rural CMSME relationships requires putting support measures in place to raise rural CMSMEs' competitiveness. In order to achieve this, rural CMSMEs would need to be fully integrated into an institutional setting that would stimulate learning and innovation and lead the CMSMEs to investing in upgrading.

Additionally, intermediaries would need to facilitate the development of rural CMSMEs' capabilities. Two separate elements need to be included in the FDI-rural CMSME linkage support programme: (i) a variety of linkage promotion services; and (ii) technical and management upgrading services, such as consulting and training to internalise the needs of the multinational corporations (MNCs), along with financial resources to incorporate any new technologies into the current production process. All or some of the following components could be included in the linkage promotion programme: (i) creating a national website and/or business directories to improve the flow of information about potential rural suppliers to potential MNC purchasers and about supply opportunities to potential suppliers; and (ii) hosting 'meet-the-buyer' events, such as seminars where the MNC explains its quality requirements, procurement procedures, and visits to MNC production sites.

Highlights of Primary Survey Results

This Policy Paper analyses the current status of access to and use of financial services by rural entrepreneurs in Bangladesh based on quantitative data and information collected from sampled enterprises and qualitative information from selected rural entrepreneurs using FGDs/KIIs and case studies from different regions of Bangladesh. Since the focus of rural entrepreneurs are mostly on CMSMEs, the analysis highlights the CMSMEs' access to finance within the adopted guidelines of Bangladesh Bank for implementing the broader policy framework of the government. The analysis also identifies gaps in access to and use of finance by CMSMEs to explore the key issues and barriers impacting the supply of and demand for rural CMSME finance.

The status in terms of access to credit is depicted in Table 2. Overall, the access to credit for the rural entrepreneurs is reasonably high (nearly 65 per cent) in formal credit sources (including banks/NBFIs, Grameen Bank, cooperatives and MFIs). As a matter of fact, many rural entrepreneurs (32 per cent) borrow from multiple sources mostly comprising of banks (both public and private) and, to a lesser extent, from specialised banks and cooperative societies. The incidence of multiple borrowing is higher for small enterprises (50 per cent) while it is around 30 per cent for cottage and micro enterprises. Further, more than 19 per cent of rural enterprises take recourse to informal borrowings (with a high of more than 20 per cent for cottage enterprises and a low of 5 per cent for small enterprises) for ease of convenience and meeting emergencies.

Table 2: Share of rural enterprises accessing credit from different sources

Source	Cottage	Micro	Small	Total
	% of enterprises accessing credit			
Banks/NBFIs	13.16	45.51	41.18	16.87
Grameen Bank	6.16	1.92	...	5.65
Cooperatives	0.91	2.56	...	1.08
MFIs	43.80	19.87	35.29	41.20
Informal market	20.30	13.46	5.88	19.42

Note: ... indicates nil.

Source: InM, CRFS quantitative survey on rural entrepreneurs, 2023

The findings highlight issues of coordination and inadequate adoption of an integrated action between the focus of financing adopted by the Bangladesh Bank and other financing institutions on the one hand and relevant organisations entrusted with the responsibility of overall development of the CMSME sector on the other. As a result, along with slow realisation of the potentials of the CMSMEs in the development of the economy especially in the rural areas, large CMSME financing gaps also persist in which the rural entrepreneurs remain the major victims. Such a situation remains a major challenge despite significant well-designed regulatory measures taken by Bangladesh Bank to support rural entrepreneurs along with transformational developments in digital financial services (DFS), agent banking and other innovative financing mechanisms and efforts to stimulate the flow of venture and other capital services to the CMSMEs.¹

Further, despite adoption of innovative facilitation services, the mismatch between demand-side needs of specific rural entrepreneurs (e.g. women entrepreneurs, CME entrepreneurs, industry based cluster entrepreneurs) and supply-side provision of banks/NBFIs continues to constrain the rural finance market in the absence of tailored support to meet the specific demand-side constraints to CMSME financing of these groups.

While a few exceptions are present, banks and NBFIs in general need to significantly improve their performance to meet Bangladesh Bank's CMSME financing expectations, particularly to fulfill the rural CMSME needs. The specific challenge is to transform the existing supply-side provision of CMSME financing of banks and NBFIs adequately customer-centric to address the demand-side constraints to financing faced by the rural entrepreneurs with specific focus on women entrepreneurs and CME entrepreneurs.

The results demonstrate that rural CMSMEs encounter more financing barriers than larger businesses; in addition to having less access to outside funding, they also have to pay higher transaction costs and risk premiums. A fifth of the rural CMSMEs are still underfinanced, and nearly three-fourths do not employ external financing from banks or NBFIs. Furthermore, cross-country studies indicate that rural CMSMEs

¹ For details on the primary survey on rural entrepreneurs, see 'Access to and Use of Financial Services by Rural Entrepreneurs in Bangladesh', Background Report No. 2025-04, Institute for Inclusive Finance and Development, 2025, Dhaka.

in countries like Bangladesh are more likely to face major financing challenges, and that the likelihood of being credit constrained declines with rises in enterprise size.

Table 3: Startup capital structure of rural CMSEs

Source of finance	Share in %			
	Cottage	Micro	Small	Total
Own source	62.30	66.70	47.05	62.75
Partners' resources	8.57	7.64	1.13	7.82
Loan from banks	7.99	18.62	36.66	13.14
Loan from MFIs	6.55	2.31	...	4.80
Loan from cooperatives	1.51	0.15	...	0.98
Loan from informal sources	10.40	4.58	15.16	8.85
Loan from other sources	2.68	...	...	1.66
Total	100	100	100	100
Average value of fixed asset, million Tk.	0.262	1.479	1.633	0.403

Note: ... means zero.

Source: InM, CRFS quantitative survey on rural entrepreneurs, 2023

It would come as no surprise that one of the biggest obstacles to the expansion and development of rural CMSMEs in Bangladesh is limited access to finance. On the other side, entrepreneurial metrics like the number of startups and enterprise dynamism and innovation are positively correlated with the availability of external financing.

In general, the financing pattern of rural CMSMEs is similar to the pattern of financing of other enterprises; the difference, however, lies particularly in the adequate and timely access to credit, knowledge and information system; provisional backups; institutional support; financing mechanisms; regulatory and legal framework; monitoring and evaluation on the part of governing systems; and lack of skills, training and awareness on the part of credit demanding entities. In short, several stages in the rural CMSME entrepreneurship financing can be identified in countries like Bangladesh:

- (i) Estimation of requirement of initial investment.
- (ii) Exploring banks, NBFIs, and other formal and informal sources of finance.
- (iii) Raising working capital for day-to-day operational activities up to profit realisation (gestation lag) or completion of operating cycle.
- (iv) Raising funds for enterprise expansion, marketing and promotional activities.
- (v) Modernisation.
- (vi) Export/import finance (pre-shipment and post-shipment finance, insurance coverage during transit etc.).
- (vii) Contingency fund for meeting emergencies/unexpected events and for financing rehabilitation which is one of the prominent features of CMSMEs.

The findings indicate that, for the rural CMSMEs, stages (i), (ii), and (vii) are the most crucial since these enterprises find it very difficult to overcome the hurdles that occur during these phases. The important

issue for rural entrepreneurs is, of course, access to the sources of finance. In reality, access to finance becomes complex due to the existence of several interlinked issues. There exists a wide and rapidly diverging gap between the demand for and supply of credit to these rural enterprises. Moreover, despite efforts by the government and other agencies several vexing issues still remain to be resolved for the rural CMSMEs such as, hassle free and easy access to credit, general lack of entrepreneurial skills (e.g. management, science and technology, marketing, administration etc.), weak mechanisms for providing support services, scattered and unorganised existence of most rural CMSMEs for being in the informal sector and remaining unregistered, and such other reasons.

Although many banks and NBFIs hold the view that the rural CMSME segment is profitable, they are unable to fund rural CMSMEs due to a number of limitations, including macroeconomic constraints, asymmetric information, and the perception of high risk in the rural CMSME segment. Compared with larger businesses, banks and NBFIs have less exposure to rural CMSMEs, offer a far smaller percentage of investment loans to these CMSMEs, and impose higher fees and interest rates on them. The study does, however, also demonstrate that banks and NBFIs can set themselves up to view CMSMEs as a key and strategic business. Through relationship lending, specialised banks and NBFIs can, in fact, overcome the opaqueness of rural CMSMEs. They can also leverage new technologies, business models, and risk-management systems to provide a wide range of products and services on a large scale.

Policy Implications and Way Forward

Rural entrepreneurship in Bangladesh refers to a type of individual job that seeks for plausible and rewarding opportunities through establishing new enterprises that facilitate expansion and desirable structural change of the rural economy. Rural business owners and entrepreneurs play important roles in the process as they foster innovative and profitable concepts. At various phases of rural economy's growth, rural entrepreneurs can play specific roles.

1. **Factor-driven stage:** Distinguished by an unskilled labour force and a predominant agriculture sector;
2. **Rural nonfarm growth stage:** In which rural entrepreneurship starts to grow and CMSEs begin to flourish mostly in the informal sector; and
3. **Efficiency and innovation-driven stage:** During this phase, new businesses producing high-tech goods start to emerge, and rural CMSMEs gain importance as a result of modernisation and connections to urban and export markets.

The use of accumulated human capital as well as incentives for future human capital accumulation are essential regardless of the self-employment modalities, when prospective entrepreneurs can identify opportunities with high returns to skills and innovation.

The role of entrepreneurship and business development services (BDS) in Bangladesh's rural economy is critical at present, since the rural economy has undergone substantial shifts away from the agriculture sector but has experienced relatively low expansion of rural nonfarm (RNF) sector and CMSMEs. The RNF sector absorbs the majority of the low-skilled self-employed workforce. In the current structural transformation phase of the country's rural economy, RNF sector needs to absorb the growing labour force in the rural areas to improve the living standards of the rural households. This requires strengthening the relationship between rural entrepreneurship and inclusive development efforts in the rural areas.

Improving Finance for Rural Entrepreneurs

In the conventional framework, creditworthiness of the rural entrepreneurs is constrained by a lack of credit information. Since they have little or no access to traditional sources of financing like banks and other formal financial institutions, whose data is normally utilised in the compilation of credit reports, rural CMSMEs find it difficult to establish a credit history relative to their larger counterparts. Moreover, rural CMSMEs lack access to permanent assets, such as real estate or buildings, which banks typically need as security for loans. The rural CMSMEs can access credit and other financial services from banks and NBFIs by using alternatives to conventional collateral-based lending and can use collateral registries for institutional and legal protections. Further, rural CMSME funding through insolvency procedures can also contribute to the lending process. However, data limitations preclude informed conclusions as to whether specific CMSME-friendly insolvency procedures can increase CMSME access to financing, and the majority of insolvency frameworks are not appropriate for handling rural CMSME loans.

Focus on CMSME entrepreneurship for rural youth

Although the country's economy is expanding rapidly during recent years, the bulk of its working-age population is employed in low-paying, precarious jobs, and youth unemployment is high as more young people reach the working age. Giving young people the freedom to innovate and adapt to societal demands through a rise in youth entrepreneurship is one way to create decent work and inclusive growth. However, problems exist since, in addition to legal and regulatory issues, one of the biggest barriers to youth entrepreneurship is a lack of financial resources. Meeting young people's financial needs can enable them to become inventors or entrepreneurs, which will boost employment, incomes, and economic growth in the rural areas.

For young people with less education, obtaining formal financing is much more challenging. Significant economic and entrepreneurship prospects in Bangladesh can be unlocked by removing obstacles to rural youth financial inclusion. Digital financial services (DFS) are probably the first time that most young people in rural areas interact with the banking industry. The emergence of financial technology, or fintechs, is giving rise to new business models that have the potential to boost young entrepreneurship and financial inclusion in the rural areas.

Alternative credit scoring for financing rural youth entrepreneurship opens up new and exciting possibilities. Fintechs can create alternative credit scoring models that demand less collateral by analysing transactions, social media, and cell phone data in addition to conducting surveys. Instead of focusing on their limited credit history and/or assets, this Big Data can be used to create responsible financial products for young entrepreneurs in rural areas based on their education and skills. Subjective questions on entrepreneurial talents and capacities may be included in the surveys. These questions can be compared with credit scores and Big Data sets that can effectively predict default rates, giving young rural entrepreneurs access to new funding sources. Larger loans with higher payback rates can be granted to the 'missing middle' of the rural CMSMEs, who lack conventional collateral and a solid financial history, thanks to improved data insights.

Digital banking and mobile wallets targeted for young entrepreneurs in rural areas, who are typically financially excluded, can engage them in the digital economy, and can enable them to have their first financial interaction with the bank online. To offer financial products to unbanked rural youth entrepreneurs, financial service providers (FSPs) may create and deploy digital mobile-based banking solutions. In addition to offering savings, loans, and payment services on the mobile device, these mobile

wallets occasionally enable financial communication over social media platforms like Facebook and WhatsApp. Since young people are mostly familiar with the social media sites, there is a strong youth focus to the usage of these channels for payments and transactions. Additionally, DFS providers can sell financial services through distribution channels that are appealing to the young rural entrepreneurs.

The growth of business funding platforms also opens up new possibilities. In addition to traditional financial institutions and/or locally sourced informal credit, crowdfunding, peer-to-peer (P2P) lending, and venture capital financiers provide a new source of funding for young rural entrepreneurs. Fintechs can be crucial in enabling this change. P2P lending platforms have the ability to directly link rural CMSMEs seeking funding with a pool of investors, enabling the CMSMEs to select the best offer from the pool of possible investors. Incubation and accelerator programmes, which support creative start-up enterprises by providing blended financial and mentoring programmes at various phases of entrepreneurship development, offer new paradigms for rural CMSME financing.

Encouraging digital financial literacy and competence among young entrepreneurs in rural areas is the priority in the above contexts. Fintechs are increasingly integrating learning and best-practice components into their products to help their clients become more financially literate and capable. Mobile piggy banks are among the digital educational resources designed specifically for kids and young adults.

Providing financial services and client-focused products that address the requirements of young entrepreneurs in rural areas needs priority. For financial inclusion of the rural youth, FSPs and other stakeholders may work towards piloting and rolling out programmes for providing sustainable financial and non-financial services tailored to the rural young people.

Urging banks and NBFIs to use technology to make it easier for young entrepreneurs in rural areas to get loans is also important. The majority of young entrepreneurs still reside in rural areas, work in agriculture and similar activities, and have limited access to digital finance, savings, and insurance. Despite this, they are typically frequent users of mobile phones and the internet. Fintech can help financial institutions' transition from asset-based lending to cash-flow-based financing by providing solutions, such as the use of geotagging farms for remote monitoring and evaluation and determining farmers' profitability based on input and output expenses. Along the agro-food value chain, mobile banking can also help young entrepreneurs in rural areas create new, value-added products and services.

Bangladesh Bank and concerned agencies need to collect both supply- and demand-side data on financing youth-led rural CMSMEs in order to make evidence-based decisions and proceed in the right directions. This will assist FSPs and policymakers in understanding the obstacles faced by young entrepreneurs in the rural areas and in creating and providing needs-based financial services and products. In order to raise young people's financial literacy and awareness on digital banking services, Bangladesh Bank may also encourage FSPs to collaborate with non-financial organisations including telecom providers, educational institutions, and youth-serving groups. Digital financial education delivery can also help Bangladesh Bank reach more rural youth entrepreneurs in its effort to increase their financial inclusion. Additionally, adding business education, basic accounting, and financial literacy to the secondary school curriculum can help the rural young people develop their financial literacy and become successful entrepreneurs.

Bangladesh Bank may undertake initiatives such as opening Individual Development Accounts (IDA), which give rural youth financial literacy instruction and business training while also assisting them in saving for asset building or income-generating ventures. It may be necessary for IDA holders to take part in programmes for a pre-determined period in order to save money for achieving set objectives. As an

incentive, either private or public matching grants may be used to augment savings in the IDAs. At the end of the programme, the youth can use the savings as start-up capital to become an entrepreneur covering chosen income-generating and asset-building activities.

Young rural entrepreneurs could be urged to connect with entrepreneur associations and social enterprises in order to receive adequate entrepreneurship education and exposure. These organisations would support, connect, train, and empower young entrepreneurs in rural areas to come up with creative and innovative solutions to commercial and societal issues relating to rural entrepreneurship. For young rural entrepreneurs, social media offers a great platform for promoting, expanding, and maintaining their enterprises. Social media provides a solution to obstacles that might prevent young entrepreneurs in rural areas from obtaining these business services through conventional means by allowing them to communicate with clients, build business networks, promote brands, and ask for help with business issues.

Improving credit reporting for rural CMSMEs

When borrowers are more informed than lenders about their financial status and investment prospects, information asymmetries occur. Since lenders lack the information necessary to evaluate the risk posed by potential clients, this results in inefficiencies in the lending process. Credit rationing occurs when adverse selection is present because prospective borrowers are turned down for loans even if they are prepared to provide more collateral or pay higher interest rates. Credit reporting service providers (CRSPs), which include credit bureaus and credit registries, contribute to lessening the information asymmetry between lenders and borrowers by exchanging credit information. A crucial component of the financial system that makes formal financing more accessible is CRSPs. Nevertheless, there are particular difficulties in expanding rural CMSMEs' access to financing through credit reporting, and regulators (e.g. Bangladesh Bank) need to identify areas of opportunities to maximise beneficial effects.

Due to their unique working characteristics and the existence of information asymmetries, rural CMSMEs face a harder time obtaining financing than larger enterprises. In Bangladesh, rural CMSMEs are more likely to rely on trade credit and informal sources (e.g. friends, family members, and moneylenders) to finance required investment and working capital needs, and size is one of the key factors that influence the magnitude of financial constraints. The experience of microfinance sector in Bangladesh shows that the strength of the relationship and trust between lenders and borrowers determines how well information asymmetries can be addressed.

Systems for credit reporting help in bridging the knowledge gap between lenders and borrowers. Lenders can discover more about borrowers' traits, past actions, repayment history, and present debt exposure through credit reporting. With the data, lenders can conduct a more effective risk assessment of their customers. The issues of moral hazard and adverse selection caused by asymmetric information are lessened when such information-sharing structures are in place.

However, there are particular difficulties in extending credit reporting to give rural CMSMEs more access to financing. Credit reporting systems have to be timely, accurate, relevant, and contain enough data gathered methodically from all appropriate, dependable, and accessible sources. To guarantee that the CRSPs generate well-informed credit reports on rural CMSMEs, such data are needed.

As the size of the rural enterprises and the loan amount increase, these techniques may be supplemented with standardised rating systems that are comparable to those utilised for larger enterprises.

Exploring alternative financing options

Small cap equity market: Rules for identifying and establishing a small cap equities market have been released by the Bangladesh Securities and Exchange Commission (BSEC) in 2016. The Qualified Investor Offer by Small Capital Companies Rules of 2016 have been adopted by the BSEC in 2018, enabling small capital firms to conduct an IPO on the stock market. The Dhaka Stock Exchange (DSE) also introduced its DSE SME Platform, a small cap platform, in 2019. Twelve small-cap firms have expressed interest in using the bourses' SME boards to raise money in recent years in order to boost their company's expansion. The SME Platform's guidelines state that only eligible investors may indicate their desire to subscribe to the issue that SMEs are offering to raise money.

Merchant bankers, portfolio managers, asset management firms, mutual funds, collective investment schemes (CIS), stock dealers, banks, financial institutions, insurance companies, alternative investment fund managers, market makers, issuers of listed securities, Bangladeshis both residents or non-residents, individuals with a minimum net worth of Tk 10 million, and other organizations authorised by BSEC are among the qualified investors.

Venture capital: Venture capital (VC) financial investment companies make investments in start-ups or small businesses that have the potential to earn profit in the future. Typically, banks, financial institutions, and major investors make up this group. The investment may take the shape of technical expertise or management, and it is not usually financial. To put it briefly, venture capital is an alternate form of funding. Venture capital is solely interested in funding creative or potentially growth-oriented enterprises or ideas.

In 2015, the Alternative Investment Rules were approved by the Bangladesh Securities and Exchange Commission (BSEC). Under this Act, a number of private equity and venture capital firms were founded. In order to promote this industry and collaborate on creating a local smart-up ecosystem, these venture capital and private equity firms established the "Venture Capital and Private Equity Association of Bangladesh" in 2016. There are currently 27 Alternative Investment Fund Managers (AIFM), most of whom concentrate on technology-based businesses. Bangladesh Bank might be interested in participating as a venture capital fund partner.

When effectively used, VC can help implement new business ideas in the rural CMSME sector and can emerge as a major source of finance for new rural CMSME entrepreneurs. Although banks and NBFIs are still the traditional primary source of finance for new entrepreneurs in the rural CMSME sector, over time VC firms may have to emerge as a viable option for new ventures in the rural CMSME sector especially for rural women and CMSE entrepreneurs.

Angel investors: Although venture capital and angel investment activity has significantly increased in recent years, Bangladesh's startup ecosystem is still in its infancy. Angel investors are becoming more important for the expansion and success of the country's enterprise sector. As the economy grows, more business owners are looking for angel and venture capital investors to fund their enterprises. In addition to giving businesses financial support, these investors often offer mentoring and strategic guidance that is essential to their success. Their support encourages enterprises to take risks and introduce novel items that would otherwise be difficult, fostering innovation. The Angel's Network and Bangladesh Angels are two organisations/networks that are working in Bangladesh. Nonetheless, regulatory incentives are needed to promote angel investment, including from foreigners and expatriate Bangladeshis to come forward in support of rural CMSMEs.

Crowd-funding: In Bangladesh, platform-based crowd-funding methods are uncommon. Furthermore, there is a knowledge and policy gap in terms of formalisation. In Bangladesh, there are only a few organisations that provide crowd-funding services. 'FundSME.com.bd' was established by BD Venture to assist entrepreneurs in crowdsourcing funds to grow their companies. A2i of the Ministry of ICT introduced "ek-desh," a donation-based crowd-funding website, in 2020. The absence of a policy and regulatory framework is the primary reason why other private ventures that were also started have not progressed.

Impact Investing: The term "impact investing" refers to investments that are undertaken with the goal of producing quantifiable, value-based social and environmental effects in addition to financial returns that, depending on the investors' strategic objectives, may be lower than the market rate. Bangladesh has a thriving market for impact investing where a number of impact investors are operating. Fundings raised by bKash, Chaldal, Shop Up, Solshare, iFarmer, and Shuttle from mostly international organisations including the Bill & Melinda Gates Foundation, IIX Impact Partners, UNCDF, and Biniyog Briddhi are some noteworthy impact investments in Bangladesh. There is room for new initiatives to improve supply-side impact investment provision in Bangladesh, especially in light of the recent worldwide trend towards greater impact investing. In particular, little market research has been done on how common gender-lens investment is among impact investors in Bangladesh. Impact investing is not new in Bangladesh, but it still needs to acquire the proper momentum to provide the necessary resources to foster an impact investment culture. To support and grow impact investing, more knowledge and changes at the policy level are required. The National Advisory Board (NAB) could be crucial and have the chance to help various ecosystem participants work together effectively especially covering the rural CMSME entrepreneurs.

Ensuring secured lending for rural CMSMEs: Access to fixed assets, such as a building or piece of land, is less common among rural CMSMEs. Therefore, the primary form of collateral that these CMSMEs can provide in order to obtain finance is transportable assets. However, banks and NBFIs are frequently hesitant to accept movable products as collateral because of insufficient institutional and legal protections. The interests of creditors in secured lending can be safeguarded by a collateral register, which keeps track of any possible security interest in movable goods. By alerting parties to the presence of a security interest and ensuring the priority of creditors over third parties, efficient collateral registries can lower the expenses associated with credit monitoring. Collateral registries are databases of asset ownership or interest that are open to the public. Without a functional collateral registry, a comprehensive and integrated secured transactions regime cannot thrive. Through the establishment of priority based on the date of registration and the facilitation of awareness of their presence, this institutional and infrastructure mechanism supports the legislative framework of security rights in movable goods. Increased financing to rural CMSMEs can be facilitated by legal frameworks that permit movable property to be included in collateral registries. Easy, rapid, and affordable registration encourages parties to disclose transactions they might have otherwise kept hidden.

Factoring and rural CMSME finance: Businesses (sellers) sell their creditworthy accounts receivable at a discount (usually equal to interest plus service costs) in order to obtain instant cash from a specialised institution (factor) under factoring, a kind of supplier financing. In other words, by paying the business the face value of the invoices less a discount, the factor purchases the right to collect the business's bills from its clients. When invoices are due, the factor goes ahead and collects payment from the enterprise's clients.

Three key characteristics of factoring are: (i) it only involves financing accounts receivable; (ii) underlying asset is sold to the factor at a discount instead of being collateralised; and (iii) it consists of a combination of three financial services: financing, credit, and collections. The expense involved by gathering buyer information is assumed by the factor through factoring. When ‘ordinary factoring’ is used, the business sells all of its receivables. In ‘reverse factoring’, the factor only buys accounts receivable from a subset of the company's clients. The factor raises its risk exposure to a customer in this fashion, but it also saves money on information gathering and credit risk assessment, and it usually only accepts high-quality receivables.

Because cash is earned instantly rather than waiting for buyers to submit their payments, rural CMSMEs can usually choose to factor their receivable assets for a favourable cash flow condition. This is especially advantageous as factoring may assist in a variety of ways, and funding and steady cash flows are two of the largest obstacles that rural CMSMEs encounter when running their enterprises. Cash is frequently required immediately in order for an enterprise to expand, and a lack of working capital could make it more difficult for the enterprise to fulfill consumer obligations in a sustainable manner. Because they can obtain working capital financing—albeit at a discount—much more quickly, factoring offers rural CMSMEs a way to improve their cash flow. This allows rural CMSMEs to effectively contract out their credit collection procedure to the factor, which also includes checking the purchasers' credit. Moreover, while factoring is not legally a loan, the funds obtained will not be applied to the rural CMSME's debt or used as collateral, which a business could require in order to obtain a conventional bank loan.

In Bangladesh, factoring for rural CMSMEs is fraught with challenges. Due to the absence of complete credit information bureaus, data on rural CMSMEs are mostly unavailable. There is also a significant risk of fraud in the financial markets. Because of fictitious receivables or nonexistent clients, there is minimal trust in the absence of a supportive legal structure. To support factoring, a collateral registry is necessary, wherein factors can register receivables (whether assigned or transferred) and establish their rights in these kinds of assets.

Financial leases: To launch and run enterprises, rural CMSMEs require funding sources other than bank loans. One such method, financial leasing, is a tripartite arrangement where one party, the lessor, buys the asset from the supplier upon request of the lessee and leases this asset to the lessee for a period of time in exchange for leasing payments. The cost of the leased asset may or may not be amortised by the leasing payments. Therefore, financial leasing is a way for an enterprise to get medium- and long-term financing to buy the equipment and other assets that are necessary to run the business. In exchange for regular payments, the lessor—a bank, leasing business, or non-bank financial institution—buys the equipment the lessee requires from a supplier and grants the lessee use of it. The asset is still owned by the lessor, who may either give the lessee ownership of the leased asset at the conclusion of the lease or the parties may decide that the item would be restored to the lessor.

In terms of asset ownership, leasing is different from loans. The asset used as collateral in a secured loan is still owned by the borrower. In a financial lease, the lessor is the asset's legitimate owner from an accounting standpoint. Operating leases, commonly known as rent, are not the same as financial leasing. In the former, the lessor transfers almost all of the risks and benefits of asset ownership to the lessee. An operating lease, on the other hand, is basically a rental agreement for the lessee's brief or temporary use of an asset. The asset's owner, the lessor, retains all maintenance, insurance, and reward risks and benefits; these are not passed on to the lessee.

Financial leasing has the potential to alleviate information disparities in credit markets, which disproportionately impact the rural CMSMEs. Because repayments will be made from money earned from the usage of assets—and because the lessor will take back the assets in the event of default—financial leases are especially helpful to rural CMSMEs because they eliminate the requirement for a credit history. On a case-by-case basis, lessors can, in fact, ex ante evaluate the likelihood of default and loss of default. Initial down payments for financial leasing are less expensive than those for the equity component of conventional bank borrowing. Leasing encourages formality in the rural sector, where informal activity is common, from a policy standpoint. Access to formal financing sources like banks and NBFIs is restricted for informal rural CMSMEs. An organisation builds a credit history that is incorporated into the official credit information infrastructure as soon as it begins employing financial leasing. After banking institutions receive this information, rural CMSMEs will eventually be able to access more financial services.

Improving access to finance through insolvency practices: Creditors' lending decisions are influenced by the default recovery regulations that are a component of an economy's insolvency system, particularly for banks and NBFIs. Insolvency frameworks are essential to the rural CMSME lifecycle because rural CMSMEs typically have a greater failure rate than larger businesses. Another important factor in the loan process is the general soundness of the insolvency system. Banks and NBFIs modify their lending and reorganisation policies to reflect the strength of an economy's bankruptcy system, and in fact, creditor recovery rates can vary significantly based on the insolvency framework.

Most insolvency frameworks are not appropriate for handling rural CMSME loans, even though insolvency regulations are crucial for the lending process and for handling non-performing loans (NPLs). Complex criteria for handling numerous creditor claims are sometimes included in insolvency statutes, which also expect active participation from creditors and significant judicial intervention. All of these factors necessitate a substantial time and financial investment, in addition to the specialised understanding of seasoned legal specialists. Rural CMSMEs, on the other hand, are usually small businesses with few assets and few creditors. Rural CMSMEs frequently lack the resources and expertise necessary to handle complicated insolvency regimes when they encounter financial challenges.

The shortcomings of conventional insolvency legislation may be addressed by the development of a number of rural CMSME-friendly insolvency procedures. For instance, out-of-court settlements are quicker and less formal than official insolvency processes, and they may involve little or no judicial involvement. Similar to this, financial difficulty can be addressed prior to insolvency through pre-insolvency procedures. Last but not the least, debtors with few creditors and little money might benefit from specialised bankruptcy procedures, which frequently have accelerated deadlines, streamlined regulations, and reduced costs. If an efficient out-of-court settlements process is in place, viable but troubled rural CMSMEs may be preserved in situations where conventional insolvency fees are prohibitive to them. Incorporating pre-insolvency procedures into insolvency frameworks is essential for encouraging an early restructuring culture and giving rural CMSME owners a second opportunity, which in turn motivates them to take calculated risks and be more entrepreneurial.

Conducive Environment for Rural Entrepreneurship

In addition to individual or group entrepreneurial endeavors, an enabling environment that supports these initiatives is crucial for assuring the success of rural entrepreneurship development. Policies for macroeconomic stability, clearly defined property rights, and an international focus are the critical steps

in creating such an environment. It is also necessary to implement policies and programmes that are explicitly focused on the development and channeling of entrepreneurial abilities. Entrepreneurial activities at the rural level can be greatly accelerated by policies that increase the supply of entrepreneurs, develop the market for other components of successful entrepreneurship, increase the effectiveness of entrepreneurs, and increase demand for entrepreneurship. In rural areas, ‘other critical inputs’ such as entrepreneurial behaviour, or the capacity to see market opportunities, are most scarce. These factors make rural entrepreneurship more likely to thrive in places where a well-thought-out regional/local strategy may be paired with the growth of local entrepreneurial capabilities. In these situations, societal and individual entrepreneurship can be very beneficial to the economic, social, and community growth of rural areas.

Leveraging Good Practices to Design and Manage CGSs

In Bangladesh, credit guarantee schemes (CGSs) are a common tool for policymakers looking to help CMSME access financing, especially in rural areas. By assuming a portion of the loan's default risk, CGSs encourage lenders to give credit to enterprise owners who otherwise would not be able to obtain funding. Groups of borrowers who are creditworthy but would not normally be granted a loan because of inadequate collateral or credit history data can benefit from the CGSs. The CGSs therefore encourage banks and NBFIs to enter a new market and get the necessary experience without taking on a lot of risk. Banks might progressively gain experience and specialise in lending to the rural CMSME sector after initially being drawn to the guarantee schemes. In order to serve more rural CMSMEs, banks and NBFIs may be incentivised to open more branches in rural areas by collaborating on a guarantee plan. Because of the leverage effect, which permits granting more credit than capital available due to the reduced risk, a CGS also helps banks and NBFIs to grow their portfolio.

However, CGSs' effectiveness frequently hinges on how well their mechanism is designed and tailored to the requirements and goals of the rural community. Basic design elements like eligibility requirements, coverage ratios, fees, and payment policies can vary throughout CGSs. These variations somewhat reflect regional circumstances and various programme goals. Six essential elements have been identified for consideration when planning and running an effective CGS. The mission, targeting, funding (including private sector participation), pricing, risk management, regulation, and governance of the system are among them.

All parties involved in the programme must agree on the mission and set specific goals that emphasise that the CGS shall: (i) assist rural CMSMEs with limited credit and, to the greatest extent feasible, refrain from lending to businesses that would have been granted credit even in the absence of a guarantee; (ii) concentrate on the economic sectors that require the most assistance; and (iii) be financially sustainable over the long term.

Credit-constrained rural CMSMEs need to be the focus of eligibility criteria for a successful CGS. Current market participants, such as banks and financial institutions, might help define a precise set of eligibility requirements that would enable the identification of the intended target rural entrepreneurs. Entities that might obtain financing without the CGS's guarantee should be excluded from the scheme rules as much as practicable. Generally speaking, credit guarantee programmes should focus on creditworthy rural CMSMEs that lack assets which the banks can use as collateral and whose risk and growth potential cannot be evaluated by the banks. High potential future cash flows or intangible assets like intellectual property are frequently the sources of growth potential. The kind of need being financed,

such as working capital or investments, may also be a requirement for eligibility. Though their scope may be expanded to working capital in worthy circumstances, CGSs are typically designed to promote long-term investment. A CGS scheme's focus might be expanded to include specific sectors or groupings of sectors in addition to rural CMSMEs.

The relative roles of the public and private sectors, the total scope of the proposed programme, and the maximum leverage permitted for the agreed-upon amount of capital must also be decided. One of the primary objectives of the programme must be to achieve financial sustainability. Depending on the funding source, there are four main categories of guarantee schemes: mutual, corporate, international, and public. The vast majority of guarantee programmes are public guarantee programmes. They have the advantage of high credibility within the banking sector as the guarantees are paid directly by the government. The scheme's leverage effect, which will be minimal in the fund's early phases and increase as it functions well, needs to be considered when calculating the capital requirements.

Where feasible, early planning could also include conversations with market players and banks that already have experience in the target economic sectors. The government may initially decide to launch a smaller programme that provides guarantees for relatively small loans, possibly in one or two trial programmes. If the initial results show promise, the CGS can be scaled up later.

Regarding fees, it is necessary to strike a balance between sustainability and the readiness of lenders and borrowers to take part in the programme. Guarantee fees could be risk-adjusted, meaning that riskier borrowers pay higher fees, and they must at least cover the CGS's administrative expenses. Schemes will frequently need to be subsidised because it is fairly unreasonable to try to cover the entire default risk. Pricing decisions must also take into account the goal of improving financing accessibility and ensure that lower interest rates are not offset by guarantee fees, particularly since fees assessed to lenders are likely to be transferred to borrowers. Fees may be assessed according to the loan amount or the guarantee amount, with the latter being more common. Fees are typically around 2 per cent of the guarantees.

Banks and NBFIs need to be made aware of the risks, either by guaranteeing a portion of the loan or by requiring them to go through legal processes in order to reclaim the loan before it is repaid. Because they would be responsible for a portion of the lender's risk or legal fees in the event of failure, banks and NBFIs could be encouraged to thoroughly review loan applications. Previous experience indicates that CGS schemes should attempt to cover 50–70 per cent of the debt covered rather than 100 per cent in order to minimise moral hazard. In a similar vein, it has been recommended that the borrowers use personal assets to finance a portion of the loan in order to prevent moral hazard. An adequate risk assessment necessitates specialised knowledge of the rural CMSME sector and region of activity due to the variability and volatility in performance of rural CMSMEs. Furthermore, CGSs need only to cover an enterprise's commercial risk; they are unable to and are not required to address systemic risk (such as inclement weather and the input-output cycle for agricultural enterprises).

For the CGS to be regulated and overseen, a framework needs to be created. In any event, it is necessary to address precise management, openness, and thorough reporting of the creation of guarantees and expenses. This also makes it easier to evaluate and track the scheme's operational outcomes, long-term effects, and financial viability.

The goal of the assurance system must be well-defined in order to prevent conflicts of interest between various participating organisations. Since it offers the evidence of the scheme's effectiveness, measuring the actual benefits of a CGS is essential. The most crucial factor is financial additionality, which measures

how much the programme has actually increased lending to rural CMSMEs. However, programmes can also be assessed based on their financial sustainability and broader economic additionality. Because CGS is entangled with other factors, such as the generally favourable macroeconomic environment and the intra-portfolio substitution effects—that is, giving guarantees to rural CMSMEs that would have received credit anyhow—quantifying its impact based on the three criteria is still difficult.

Need to Exploit Full Potential of Islamic Finance

A key challenge in rural finance in Bangladesh is to finance investments in multi-sectoral and multi-social rural activities including CMSMEs to promote integrated and sustainable development of the rural economy. In support of such investments, Islamic finance can be an important source of financing and can facilitate portfolio diversification for institutional and high net-worth investors and serve as an alternative source of financing for rural populations and CMSMEs who prefer Sharia-compliant financial services. For example, sukuk can be used to fund development projects as well as rural CMSMEs.² Islamic finance can also increase the access to financial services of rural populations and CMSMEs since many Muslim entrepreneurs and households abstain from opening conventional bank accounts because of their interest-generating feature. Financial transactions are dominated by the conventional modes of the Islamic trading system, which can be broadly categorised as equity-based (partnership and joint venture relationship), rental-based (lessor-lessee relationship), and trade-based (buyer-seller relationship and co-ownership). These options are also organised as Islamic insurance (Takaful) and Islamic bonds (Sukuk).

The potential of Islamic finance in Bangladesh has not yet been fully realised in terms of advancing the rural finance agenda, including improved livelihoods for marginal and small farmers, financial inclusion of the excluded, equitable wealth distribution, growth of productive rural CMSMEs, and other facets of inclusive rural development.

Given its benefits, Islamic financing has the potential to become a major component of Bangladesh's rural finance sector especially for the rural CMSMEs. In order to make progress, it is critical to eliminate societal misconceptions about Islamic finance.

Building income-generating assets and businesses, stabilising consumption, and safeguarding rural CMSMEs from future hazards are three crucial financial services that Islamic microfinance concepts offer to the impoverished and low-income communities in the context of rural finance. A successful Islamic MFI must act less like a banker and more like a trader and invest in rural CMSMEs. By offering transportation services, buying in bulk at wholesale costs, assuming ownership of the exchanged products, and marketing the goods, a trader will add value to the transaction in contrast to a banker. These characteristics set an ideal Islamic MFI apart as a risk-sharing organisation, which is a significant divergence from the typical banking mission and culture.

Islamic finance requires Islamic MFIs to mediate funds to rural CMSMEs in the most effective and responsible way possible, without distinguishing between the functions of financiers and investors. Risks associated with the business are given greater attention than risks associated with repayment. Instead of focusing on repayment capacity, financing will be given based on current business potential. Without making a distinction between the roles of financiers and investors, Islamic finance mandates that Islamic

² A sukuk is an investment instrument (traded like a conventional bond) that provides the investor with undivided ownership of an underlying asset. The volume of annual sukuk issuances reached \$75 billion in 2016, bringing the volume of outstanding sukuk close to \$320 billion in Asia. See, Islamic Financial Services Board. 2017. Islamic Financial Services Industry Stability Report. Kuala Lumpur.

MFIs route money to rural CMSMEs in the most efficient and responsible manner feasible. Risks related to the business receive more consideration than repayment-related risks. Financing will be provided based on existing business potential rather than payback capabilities. Islamic MFIs are allowed to engage in value chain activities and communicate with their clients. By doing this, Islamic microfinance helps rural CMSMEs become financially included while also expanding their economic opportunities.

Further, a comprehensive economic empowerment can be promoted through merging of financing, partnership, investment support (value chain financing) for rural CMSMEs along with other non-financial services. These interventions can increase access to affordable financing for small farmers and CMSMEs in rural areas.

Working capital for rural CMSMEs can be provided through "salam" transactions under Islamic finance. Salam guarantees them a market in addition to operating money. Islamic MFIs, for instance, buy the company's goods at a discount and provide him or her money in advance to pay for labour, supplies, and other items that will be delivered after production. The MFIs will bargain with purchasers to sell the goods they anticipate receiving in order to benefit from the transaction. Both the client and the MFI benefit from success when a business trader method (Islamic finance) is used, resulting in a win-win scenario. By extending beyond their conventional position as financial intermediaries, Islamic MFIs can empower their rural clients (such as CMSMEs and impoverished farmers) significantly and sustainably improve the standard of living for the rural populace.

Some Key Recommendations

In the backdrop of increasing potential for digitalisation, strengthening infrastructure, and better and greater data-availability to develop more targeted financial service provision to rural CMSME entrepreneurs, several actions may be taken by Bangladesh Bank and the policy makers to improve the access to and use of quality financial services by the rural CMSME entrepreneurs.

Adopt a more coordinated approach to CMSME lending to enhance policy coherence. Bangladesh Bank may adopt a more coordinated approach for which SMESPD needs to employ dedicated staff and financial resources to coordinate with other government agencies and private sector entities with responsibilities and mandates for rural CMSME financing and development. The aim will be to improve inter-agency efforts to co-implement a collective CMSME entrepreneurship financing, development and competitiveness agenda. Specifically, this may involve developing a shared CMSME national strategic vision in line with relevant national policies.

Incentivise the digital integration of rural CMSMEs as an in-built mechanism for financing: Bangladesh Bank may actively incentivise the rural CMSMEs to become digitally integrated and digitalise their financial transactions.³ Digital transformation will bring operational efficiency to FSPs, thereby reduce cost of funds for rural CMSMEs, enable Bangladesh Bank and other regulators to undertake real-time data monitoring of their programmes and adopt data-driven evidence-based policy

³ Public-private partnerships (PPP) may be used to support the digital integration of rural CMSMEs. For example, digital market linkages may be done through e-market platforms operated by private or public sector entities. Moreover, digital integration and formalisation may be prioritised by social media marketing such as Facebook commerce (f-commerce). Another approach to achieve digital integration of rural CMSMEs is their formalisation through making the process simpler and reducing documentation requirements and costs involved. For example, for rural CMSMEs, National ID card (NID) of the entrepreneur may be accepted in place of a trade license (e.g. for first three years of operations). The MRA's national database on microenterprises may be expanded by incorporating small and medium enterprises to serve not only in monitoring, but also for strategising and making rural CMSME-specific policies, incentives and interventions.

decisions, and improve transparency and good governance of rural CMSMEs. Further, digital financial footprints can be used by rural CMSMEs to provide evidence of their credit worthiness, and support banks/NBFIs to make sound financing decisions. The benefits could be transferred to rural CMSMEs through lower interest rates and speedier disbursements. Digital data on rural CMSME performance will also build the business case for banks/NBFIs to better serve the rural CMSMEs.

Encourage banks/NBFIs to design and provide tailored support to rural CMSMEs especially to rural women and CMSEs entrepreneurs: Bangladesh Bank may adopt a programme to build a business case for serving the rural CMSME market and encourage banks and NBFIs to serve the market, in particular rural women and CMSE entrepreneurs. The initial focus may be given on banks/NBFIs that have the willingness and potential to become specialists in CMSME financing. The strategic thrust would be to facilitate the uptake of new tailored products for rural women and CMSE entrepreneurs. Bangladesh Bank may share good practices from across developing countries to build the business case for banks/NBFIs to specialise in serving rural women and CMSE entrepreneurs.⁴

Introduce policy incentives for banks and NBFIs to emerge as specialists in CMSME financing, especially for financing rural women and CMSE entrepreneurs: Bangladesh Bank, with support from relevant government agencies, may introduce a programme to encourage the specialisation of banks and NBFIs to serve the CMSME market with special focus on rural women and CMSE entrepreneurs. This will encourage some banks/NBFIs to serve this specific market segment on a commercial and sustained basis. Further, this will serve the aims of the SME Policy 2019 and the National Financial Inclusion Strategy (NFIS, 2021-2026) to develop tailored products and services for CMSMEs.⁵ In order to ensure that rural entrepreneurs, especially the women and CMSE entrepreneurs, do not remain underserved, Bangladesh Bank may provide incentives to those banks/NBFIs that specialise in lending to or target rural women and CMSE entrepreneurs. Similarly, SOCBs, SBs and non-scheduled banks have significant rural and suburban presence and sector-specific mandates and these institutions could possibly have an advantage in serving the rural CMSME market.

Develop agencies with effective and efficient capacity in providing tailored business development services (BDS) to rural women and CMSME entrepreneurs: For rural CMSMEs in general and more specifically for rural women and CMSEs, most entrepreneurs are not ‘finance-ready’ for banks/NBFIs and require BDS on business registration, taxation, trade licenses, financial record keeping, business plan development as well as on awareness raising on equity investments and other financing options. Along with technical knowledge, they need mentoring on different aspects of business model such as revenue management, product distribution, legal matters (e.g. handling non-payments, contract breaches) and sales and marketing. As such, they need support on financial literacy of entrepreneurs.

⁴ Bangladesh Bank may provide assistance in tailoring their CMSME financial products to rural women and CMSE entrepreneurs and incorporating non-financial support that addresses their gender-specific and size-related CMSE financing constraints. The assistance may also cover customer-centric product development, marketing, delivery channels and customer servicing.

⁵ Bangladesh Bank would also benefit from developing a group of specialist banks/NBFIs in serving the rural CMSME market which eventually would reduce its monitoring burden of requiring all banks/NBFIs to meet CMSME financing targets. On the part of the banks/NBFIs, they will enjoy greater operational efficiency through making strategic choices regarding their market niche and value proposition based on their capabilities, leadership mindset, and values. At present, the regulatory requirement that all financial institutions have to annually meet CMSME lending targets and targets for women entrepreneurs, has not fully delivered the intended results on CMSME financing nor on closing gender or rural-urban gaps.

There is scope to build IT enabled incubation service provision in different geographic regions in Bangladesh in support of providing financial literacy to rural CMSME entrepreneurs and address rural women and CMSE entrepreneurs' gender and business sector specific needs and constraints to CMSE financing and BDS. Incubation or acceleration support can be tailored to specific economic sectors as well.

Encourage alternative financing options for rural CMSMEs: In addition to financing by existing channels including banks, NBFIs and MFIs, other alternative channels such as small cap equity, venture capital (VC), crowd funding and angel investment have significant potential to emerge as viable finance sources for rural CMSMEs in Bangladesh. For the purpose, awareness building is necessary for equity investors/VC firms on the viable business case to extend venture capital specifically to rural CMSEs and women's entrepreneurs.

Concluding Remarks

In Bangladesh, 68 per cent of the population lives in the rural areas (BBS Population Census 2023) and the country's development largely depends on raising the standard of living of the rural masses and overall progress of the rural economy. In the national economy, the rural CMSMEs play an important role in generating employment, creating wealth and prosperity, and alleviating poverty. The country's development agenda recognises the critical role that rural entrepreneurship can play through enhancing economic value to the rural nonfarm economy by creating new methods of production through innovation and new technologies, producing new products and services, expanding value chains and new markets, and accelerating a unique blend of growth opportunities for agricultural activities.

A recent Bangladesh Bank study, while analysing the potential role of CMSME output on the country's economic growth, indicates a significant positive impact of CMSME output on GDP growth and estimates that the contribution of the CMSME sector to GDP growth is about 30.4 per cent.⁶ Although Bangladesh's greater growth potential lies in the emerging high-tech industries, but the unexplored potential of the conventional labour-intensive rural CMSME sector is also important to realise the desired diversification and balanced, inclusive and sustainable development of the country to achieve its long term vision of emerging as smart and high income country by 2041.

Since the CMSMEs, rural CMSMEs in particular, are disproportionately handicapped by a lack of finance, they can avail a stronger boost in growth than larger enterprises if financing is provided. The present study also confirms that rural CMSMEs not only report higher financing obstacles, but they are also more adversely affected by these obstacles. This might be due partly to a lack of other financing sources, and partly because it hinders rural CMSMEs from taking advantage of economies of scale. It has been argued that production technologies follow a step-function, and that credit might be needed for CMSMEs to make the jump to the next step e.g. a move from manual to improved technologies.⁷

The present study demonstrates that the access to finance gap for the rural entrepreneurs is a complex problem driven by several factors including lower returns, higher risk perceptions, an uninspiring

⁶ See, Begum, L.A. and others, 2022, estimating the Contribution of SMEs Output on GDP Growth in Bangladesh, Special Research Work-SP 2022-02, Research Department, Division-4 (Special Studies and Fiscal Affairs Wing), Bangladesh Bank, Dhaka.

⁷ See, Banerjee, A.V. and E. Duflo, 2011, Poor Economics: A Radical Rethinking of the Way to Fight Global Poverty, Population and Development Review, <https://doi.org/10.1111/j.1728-4457.2011.00462.x>

regulatory environment, and a lack of intermediary skills, experience and capacity. In practice, in Bangladesh: (i) banks/NBFIs do not provide adequate finance to the rural CMSMEs; (ii) these can often earn high returns in their core markets, giving them little reason to take on additional risk in the rural CMSME market; (iii) banks/NBFIs incur higher administrative costs by lending to rural CMSMEs; (iv) banks/NBFIs have difficulties in providing long-term capital; and (v) banks/NBFIs have limited information, skills and regulatory support to engage in rural CMSME lending.

For Bangladesh's rural CMSMEs, these features of the financial system create unfavorable lending conditions. High interest rates and collateral requirements for rural entrepreneurs are a result of the perceived increased risks, higher expenses, and lack of skills associated with investing in CMSMEs in rural areas. Additionally, posting collateral is made more difficult by the fact that the majority of rural CMSMEs work in settings with lax property rights and inadequate contract enforcement, where borrowers frequently lack legal titles to their homes or land and are consequently unable to utilise them as collateral.

In these situations, a self-reinforcing market failure further hinders rural CMSME lending because the absence of rural CMSME lending raises costs and creates unfamiliarity and knowledge gaps, which result in adverse selection, raise costs and interest rates, and reduce lending.

In the future, it will be crucial to assess the optimal timing and balance of various initiatives in the larger portfolio of supportive interventions surrounding rural CMSME financing, although the current study has proposed a number of recommendations covering various financing modes. In order to provide direct financial support to rural CMSMEs, this would necessitate a comparison of the cost-effectiveness of interventions that improve financial structures, such as those that concentrate on bolstering property rights and contract laws (e.g., collateral recovery procedures), and those that try to lessen information asymmetries (e.g., credit bureaus and standardised accounting systems).

Annex 1

List of Reports under the Comprehensive Rural Finance Study

Sl. no	Title	Reference No.
Analytical and Survey Report		
1.	Reshaping Rural Finance in Bangladesh: Key to Building Prosperous, Equitable and Inclusive Rural Society	Study Completion Analytical Report: Summary Results and Major Recommendations
2.	Pathways To Smart and Inclusive Rural Bangladesh: Key Recommendations for Reshaping Rural Finance	Comprehensive Summary of Major Recommendations
3.	গ্রামীণ বাংলাদেশে অন্তর্ভুক্তিমূলক উন্নয়ন প্রসারে আর্থিক খাতের সমস্যা ও চ্যালেঞ্জ: ভবিষ্যত যাত্রা পথের জন্য কৌশলগত সুপারিশের সারসংক্ষেপ	Analytical Summary Report in Bangla: Major Findings and Recommendations
4.	Bangladesh: Report of the Rural Finance Survey 2023	National Survey Report
Policy Paper and Policy Brief		
1.	BANGLADESH: Review of Rural Finance System and Policy Implications	Policy Paper No. 2025-01
2.	Access to Finance: The Smart Vehicle of Empowerment for Vulnerable Communities in Bangladesh	Policy Brief No. 2025-01
3.	Dynamising Rural Enterprises in Bangladesh: Access to Finance is the Key	Policy Paper No. 2025-02
4.	Financing Industry Based Clusters in Rural Bangladesh	Policy Paper No. 2025-03
5.	Rural Women Entrepreneurship and Access to Finance: Challenges and Opportunities in Bangladesh	Policy Paper No. 2025-04
6.	Access to Finance of Rural Farming Households in Bangladesh: Challenges and Opportunities	Policy Paper No. 2025-05
7.	বাংলাদেশের গ্রামীণ নারী উদ্যোক্তাঃ সফলতার পথে চ্যালেঞ্জ এবং অর্থায়নের ভূমিকা	নীতি সংক্ষেপ ২০২৫-০১
8.	বাংলাদেশে গ্রামীণ কৃষি পরিবারের অর্থায়নঃ সুযোগ, চ্যালেঞ্জ ও সম্ভাবনা	নীতি সংক্ষেপ ২০২৫-০২

Background Report		
1.	Changing Face of Rural Finance in Bangladesh: Achievements and Future Challenges	Background Report No. 2025-01
2.	Financial Needs of Selected Marginalised and Vulnerable Communities in Bangladesh	Background Report No. 2025-02
3.	Access to Finance for Rural Entrepreneurs in Industry Based Clusters of Bangladesh	Background Report No. 2025-03
4.	Access to and Use of Financial Services by Rural Entrepreneurs in Bangladesh	Background Report No. 2025-04
5.	Access to Financial Services by Rural Women Entrepreneurs in Bangladesh	Background Report No. 2025-05
6.	An Overview on Rural Finance in Bangladesh Structure, Policies and Priorities	Background Report No. 2025-06
7.	Supply Side Analysis on Comprehensive Rural Finance	Background Report No. 2025-07
8.	Access to Finance of Farming and Non-farming Households in Rural Bangladesh	Background Report No. 2025-08
9.	Penetration of Agent Banking and Mobile Financial Services in Rural Areas of Bangladesh	Background Report No. 2025-09
10.	Regional Variation in Access to Finance by Rural Households in Bangladesh	Background Report N0. 2025-10

Report Availability

This publication, along with all other background papers of the Comprehensive Rural Finance Study (CRFS), is available in digital format on the official website of Bangladesh Bank.

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