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Are Banks Engaged in SME Cluster Financing?

Issue No. 03

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Are Banks Engaged in SME Cluster Financing?

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Forewords

As part of the ongoing dissemination of BIBM research outputs, the present research workshop contains the findings of the research workshop titled "Are Banks Engaged in SME Cluster Financing?"

Small and medium enterprises (SMEs) have formidable role in creating employment, contributing to export earnings, reducing poverty, and encouraging product innovations in any economy especially for a developing one. Considering the importance, stakeholders in almost all economies have been undertaking policies and strategies to promote this sector. In light of this, clustering is a known strategy to reinforce and consolidate SMEs through promoting interconnectedness, competition, and cooperation. It is evident that cluster-based SME development may enjoy a competitive advantage, ensure economies of scale and most importantly, the hurdles of access to finance may effectively be handled by developing a performing cluster. However, simply having a number of similar SME units together or the creation of an SME assembly is not a sufficient condition to obtain a positive outcome.

It gives me immense pleasure to publish and distribute this research output to the regulators, practitioners of the banks, the academics as well as the common readers. I hope this research paper will be a useful guide especially for the supervisory authority of the financial market and the operators who are targeting smaller and medium size enterprises and vulnerable sections of the society.

Dr. Md. Akhtaruzzaman
Director General

Acknowledgment

The research workshop titled "Are Banks Engaged in SME Cluster Financing?" comes to light with the immense support from many persons, especially from the executives of different banks and non-bank financial institutions to identify the financing models, challenges and ways out related to their SME and cluster-based operations. We would like to extend our gratitude to Dr. Md. Akhtaruzzaman, Honorable Director General of BIBM for his valuable advice, observations and thoughts to progress our research work.

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List of Acronyms

AI	Artificial Intellenge
A-AVT	Anti-Advanced Volatile Threat
ADC	Alternate Delivery Channel
APT	Advanced Persistent Threats
ATM	Automated Teller Machine
BB	Bangladesh Bank
BGD-eGov CIRT	Bangladesh Government's Computer Incident Response Team
BIBM	Bangladesh Institute of Bank Management
CASB	Cloud Access Security Broker
CC(GRC) P	Certified Cyber (Governance Risk and Compliance) Professional
CCISO	Certified Chief Information Security Officer
CCNA	Cisco Certified Network Associate
CCNP	Cisco Certified Network Professional
CCO	Cybersecurity Compliance Officer
CDRP	Certified Data Recovery Professional
CEH	Certified Ethical Hacker
CERT	Computer Emergency Response Team
CFR	Cyber Security First Responder
CGEIT	Certified in the Governance of Enterprise IT
CHFI	Computer Hacking Forensic Investigator
CIO	Chief Information Officer
CIRT	Cyber Incident Response Team
CISA	Certified Information Systems Auditor
CNSS	Committee on National Security Systems
CPEH	Certified Professional Ethical Hacker
CPISI	Certified Payment-Card Industry *Security* Implementer
CREA	Certified Reverse Engineering Analyst
CSA	Certified SOC Analyst
CSM	Certified Security Manager
CSSLP	Certified Secure Software Lifecycle Professional

CTO	Chief Technical Officer
CySA	Cyber Security Analyst
DAM	Data Activity Monitoring
DB	Database
DDoS	Distributed Denial of Service
DLP	Data Loss Prevention
DRM	Data Centric Security and Rights Management
ECSA	EC-Council Certified Security Analyst
EDR	Endpoint Detection and Response
FIM	File Integrity Monitoring
GIAC	Global Information Assurance Certification
GCCC	GIAC Critical Controls Certification
GRC	Governance, Risk and Compliance
HoIT	Head of Information Technology
iSOC	Intelligent Security Operation Center
IACRB	Information Assurance Certification Review Board
IBM	International Business Machines Corporation
ICT	Information and Communication Technology
IDAM	Identity and Access Management
IDS	Intrusion Detection System
IOC	Indicators of Compromise
IPS	Intrusion Prevention System
ISO	International Organization for Standardization
ITIL	Information Technology Infrastructure Library
JNCIA	Juniper Networks Certified Associate
LGM	Lead IT Governance Manager
MCSE	Microsoft Certified System Engineer
MCTS	Microsoft Certified Technology Specialist
MDM	Mobile Device Management
MTTD	Mean Time to Detect
NAC	Network Access Control

NBA	Network Behavior Analysis
NSM	Network Security Management
OCP	Oracle Certified Professional
OT	Operational Technology
PAM	Privileged Access Management
PMP	Project Management Plan
POST	Point Of Sale Terminal
PTO	Paid Time Off
RHCE	Red Hat Certified Engineer
RHCSA	Red Hat Certified System Administrator
SIEM	Security Information and Event Management
SMS	Short Message Service
SOAR	Software *Security* Assurance State-of-the-Art Report
SOC	Security Operation Center
SOP	Standard Operating Procedure
SSL	Secure Sockets Layer
SSO	Single Sign On
ROI	Return on Investment
UEBA	User and Entity Behavior Analytics
UTM	Unified Threat Management
WAP	Web Application Appliance
2FA	2 Factor Authentication

Executive Summary

Clustering is a recognized strategy to strengthen and consolidate SMEs through promoting interconnectedness, competition, and cooperation. Policymakers take interest in cluster-based SME development because of the evidence that SMEs may enjoy a competitive advantage and economies of scale by sharing and cooperating. And very importantly, the challenges of access to finance of the SMEs may effectively be handled by developing an effectively performing cluster. Simply having a number of similar SME units together or the creation of an SME assembly is not a sufficient condition to obtain a positive outcome. To optimize the benefits of the cluster, these performance based criteria should be attained. Generally, one should not expect spontaneous attainment of all these criteria, rather it is crucial for the policymakers and other stakeholders to intervene effectively for developing advantageous SME clusters. And these clusters might be very useful in overcoming the key financing difficulty of the SMEs that originates from the problems of asymmetric information, inadequate assets and collateral securities, diseconomies of scale, and absence of markets. Thus, both SMEs and the financing banks are beneficiaries of a judiciously developed cluster.

In the context of Bangladesh, a good number of geographically concentrated SME clusters were identified back in 2013. Though Bangladesh Bank has undertaken some remarkable measures for ensuring greater access to finance of the SMEs of the country, a lot has to be done to create a win-win situation for the supply side (bank and financial institutions) and the demand side (SMEs). The cluster approach of SME financing might be a game-changer towards that end. Published and reported data reveal certain exposure of banks in the area of SME cluster financing. However, are banks/financial institutions really following the cluster approach in their 'SME cluster financing segment'? Identification of the performing cluster' should be an initial crucial step for effective SME cluster financing. How do banks ensure that the concerned SME cluster is having the required attributes? Are the banks' existing cluster-financing approaches distinctive from that of overall SME financing? If not, then what should be the policy and operational strategy for developing an effective cluster financing approach in Bangladesh? On the above background, the study attempts to attain the following specific objectives: One, to examine the existing models and trends of the SME cluster financing by banks in Bangladesh; and two, to come up with a suggestive framework for identifying 'performing cluster' and financing for attaining optimum benefits by the SMEs and the banks. The study is based on primary data, secondary data, and cases.

The study came up with the following observations and recommendations:

One, A generic SME strategy may not work for performing cluster development. Cluster development and cluster financing received adequate policy attention in the country to date. SMEF performed the primary and essential job of identification of clusters based on the geographical proximity of SMEs of all sectors, and now focusing on interventions. SMEF's cluster identifications and interventions led down the foundation for furthering. For attaining benefits, it is time for the up-gradation of the cluster mapping by identifying current status, performance levels and the challenges thereof. To perform the job, SMEF, other relevant government agencies, SMESPD of the BB, specialists, and experts of the areas are required to coordinate for formulating and adopting appropriate strategies.

Two, Despite some success stories, banks and NBFIs are yet to adopt an effective cluster financing approach. SMESPD may think of allocating special attention to supporting and incentivizing cluster financing by banks and NBFIs. A separate cell and strategy are needed in the SMESPD to handle this special type of SME financing model. Special cluster development and financing models for women entrepreneurs might be contributory in handling even greater challenges of SME financing to the women SME entrepreneurs. Banks and NBFIs should be required to formulate bank-specific SME cluster financing policy and strategy to effectively implement their SME cluster financing targets, and regular reporting with data on their cluster financing, business models, and financial performance for better monitoring and support. A minimum level of targets of SME cluster financing may be imposed by the central bank with a tagged incentive structure.

Three, The volume of cluster financing by banks and NBFIs remained insignificant of the total, and in most instances, these financing activities are hardly distinguishable from that of the regular SME financing. This special approach of financing may have similarities but should not be diluted with the regular form of SME financing, and banks and NBFIs should handle cluster financing under the specific and customized policy and strategic guidelines using a separate desk. Alongside policy support, banks and NBFIs need to invest to revitalize their SME clusters to generate maximum benefits. Identification of the status, performance, and level should be the primary job to lend to a particular cluster. Based on the given criteria, banks and NBFIs may assign a score and standardize the assessment model for the selection of the performing cluster in the process of financing.

Four, Involvement of additional costs and efforts may be discouraging for banks and NBFI in undertaking SME financing. This is even more obvious for the SME cluster financing. Bangladesh Bank has significantly expanded its CSR activities in recent years, with pledging financial support to several projects. Besides, BB has been encouraging and offering incentives to banks and financial institutions to undertake CSR activities to attain sustainable development. To support cluster financing, the involvement of banks' additional costs (not the financing part) might be considered or counted as their CSR activities. This may be an encouraging factor for banks to undertake cluster promotion and financing. Even after ensuring all the policy support and incentives, banks and NBFIs have their comfort zones and financing areas. All banks may not have adequate capacity and advantages in fulfilling SME cluster financing targets effectively. In such a scenario, a provision or model in line with the 'priority sector lending certificate' might be contributory both for the banks/NBFIs and the policymakers of the country.

Finally, cluster development and the associated financing is a multi-stakeholder approach where policy and operational coordination would help to stimulate innovations, manage resources efficiently, and can help environmental and social challenges. All stakeholders need to realize that if SME financing is a 'Credit plus approach' then SME cluster financing has to be a 'Credit Plus Plus approach' that requires greater investments and efforts, and the benefits would also be much higher and sustainable.

Are Banks Engaged in SME Cluster Financing?

1. Introduction

'SME' is a popular jargon mostly meant for the group of relatively smaller enterprises that need policy support to grow and/or to sustain. Small and medium enterprises (SMEs) are very important[1] economic force especially for a developing country because of their formidable role in creating employment, contributing to export earnings, reducing poverty, and spurring product innovations. Considering the importance, policymakers in almost all categories of economies have been undertaking policies and strategies to promote SME sectors.[2] In this context, clustering is a recognized strategy to strengthen and consolidate SMEs through promoting interconnectedness, competition, and cooperation. Policymakers take interest in cluster-based SME development because of the evidence that SMEs may enjoy a competitive advantage and economies of scale by sharing and cooperating. And very importantly, the challenges of access to finance of the SMEs may effectively be handled by developing a performing cluster.

Physical closeness or proximity of SMEs creates potentials for creating a cluster by improving productivity, innovation, supply chain, marketing, profitability, and growth. However, simply having a number of similar SME units together or the creation of an SME assembly is not a sufficient condition to obtain a positive outcome. It is possible to have a good number of SME units physically together with missing basic criteria of a performing cluster: networks, linkages, competition, and cooperation. To optimize the benefits of the cluster, these criteria should be attained. Generally, one should not expect spontaneous attainment of all these criteria, rather it is crucial for the policymakers and other stakeholders to intervene effectively for developing advantageous SME clusters. And these clusters might be very useful in overcoming the key financing difficulty of the SMEs that originates from the problems of asymmetric information, inadequate assets and collateral securities, diseconomies of scale, and absence of markets. Thus, both SMEs and the financing banks are beneficiaries of a judiciously developed cluster. It is about

[1]"MSMEs are often described as the 'engine of growth' for emerging economies from the perspective of employment and innovation." (ESCAP, 2020).

[2]"The UN estimates that MSMEs constitute 90% of global businesses and account for 60% to 70% of global employment." (Cometto, 2019).

an approach of targeted financing in a consciously developed SME cluster platform. Alongside policymakers, banks/financial institutions have a crucial role to play to contribute to SME cluster development as a key stakeholder of the SME financing process. For identifying strategies by the policymakers and stakeholders, it is crucial to understand the current state of the clusters, performances, and levels. However, identifying some generic indicators to understand the current status, performances, and levels is a challenge itself.

SMEs have been getting notable policy attention over the years, however, clustering SMEs as a strategy received a relatively limited impetus. In the context of Bangladesh, a good number of geographically concentrated SME clusters were identified back in 2013. As in most other developing countries, SMEs of Bangladesh confront a number of inherent financing challenges covering inadequate access[3]; lack of bankable attributes; lack of collateral security; diseconomies of scale; and being highly vulnerable to business and economic turmoil. Though, Bangladesh Bank has undertaken some remarkable measures for ensuring greater access to finance of the SMEs of the country, a lot has to be achieved to create a win-win situation for the supply side (bank and financial institutions) and the demand side (SMEs). The cluster approach of SME financing might be a game-changer towards that end. Published and reported data reveal certain exposure of banks in the area of SME cluster financing. However, are banks/financial institutions really following the cluster approach in their 'SME cluster financing segment'? 'Identification of the performing cluster' should be an initial crucial step for effective SME cluster financing. How do banks ensure that the concerned SME cluster is having the required attributes? Are the banks' existing cluster-financing approaches distinctive from that of overall SME financing? If not, then what should be the policy and operational strategy for developing an effective cluster financing approach in Bangladesh?

[3] "Amongst the countries reviewed by ESCAP (2020) - Bangladesh, Bhutan, Cambodia, Lao People's Democratic Republic, and Nepal. Cambodia has the highest finance gap followed closely by Lao Peoples Democratic Republic and Nepal. While examining the finance gap of microenterprises and SMEs, the gap revealed in Bhutan, Cambodia, Lao People's Democratic Republic and Nepal are not substantial. However, in Bangladesh the differences are much larger between microenterprises and SMEs with only 14% of microenterprise demand being met"

On the above background, the study attempts to attain the following specific objectives: ***One,*** to examine the existing models and trends of the SME cluster financing by banks in Bangladesh; and ***two,*** to come up with a suggestive framework for identifying 'performing cluster' and financing for drawing optimum benefits by the SMEs and the banks.

The study is based on both primary and secondary data. Published documents and data of Bangladesh Institute of Bank Management (BIBM), SME and Special Program Department (SMESPD) of the Bangladesh Bank (BB), and SME Foundation (SMEF) were extensively used for the study. A questionnaire survey was conducted for the banks and financial institutions and 29 banks/NBFIs responded (list of banks and the questionnaire are attached as appendix-1 and appendix-2). Besides, a Focus Group Discussion (FGD) was arranged to identify and clarify a few relevant issues and to validate certain information (list of participants and the discussed issues are given in appendix-3 and appendix-4). Cases were compiled based on the discussion with the selected banks/NBFIs that are having relatively high exposure in the cluster financing. SMESPD of BB, and SME Foundation supported remarkably in gathering both primary and secondary information. This is a supply-side study. It draws heavily on a very relevant BIBM study that considered both the demand and supply side of cluster financing.[4] This report has been finalized after incorporating the comments of the participants and experts of the banking sector.

2. Clustering Approach in SME Credit and Cluster Identification for Financing

2.1: Relevance of SME Clusters for Efficient Bank Financing

Effective bank financing to SMEs is particularly difficult in a market environment of SMEs which is commonly dispersed and there is a lack of relevant information and knowledge on management and operation. To attain the development goals, the financing of SMEs in industrial clusters has been given great concern; and financing has been a critical bottleneck problem in the development of SMEs (Ke Liu, 2013). Banks need or should have access to adequate information regarding SME operations and performances to assess

[4] Habib, Shah Md Ahsan, Md Ashraful Alam, Fahmida Chowdhury, Md. Shahidullah, Zakir Hossain, and Rexona Yesmen (2016) SME Cluster Development: Implications for Banks, Research Monograph No-16, BIBM.

their intentions, cash flows, capabilities, and potentials to ensure credit risks involved in offering financing services to SMEs. It is argued that cluster helps to resolve these key financing challenges of the SMEs through different ways (ADB, 2012): cluster increases the symmetry of information (i.e. a bank is familiar with the situation of local enterprises, as a result, it increases the opportunity of getting the loan); clusters help to conquer the moral hazard; cluster helps reducing the cost for banks (i.e. banks may benefit a lot from the economies of scale through the loan to many enterprises within the cluster). More specifically, the systemic information dissemination system, human relation network, and other external implications caused by cluster characteristics weaken the information asymmetry between banks and SMEs. Banks may be unwilling to offer credit facilities to a single and independent SME on its capacity, however, while banks may be willing to provide loans to the SMEs in a cluster at lower administrative cost and risk on their collective capacity.[5]

Published literature points to the remarkable beneficial impacts of the performing SME clusters. SME clusters promote cooperation, linkages, inter-person relationship, and inter-firm relationship, and the higher the level of inter-firm relationships, the higher the level of bank financing performance (Jian-yong, 2013). Inter-person[6] relationships can help companies to get support and resources in the clusters like a guarantee which may work as an alternative to the collateral security (Hoang and Antoncic, 2003). Practically, all the critical factors for the bankability of the SMEs like targeted financial and legal infrastructure; targeted financing instruments; information symmetry, and collateral requirements are duly promoted in the process of the development of an SME cluster. A performing cluster makes it easy for the financing banks to manage credit risk and help SMEs availing comprehensive financing support from the banks and financial institutions.[7]

[5] "The more stable the long-term oriented trade relationship between enterprises, the more opportunities of external financing, the more possibilities of enterprises' getting financial resources from the bank" (Ke Lui, 2013)

[6] Inter-person relationship can be seen as resources platform for managers, including financial, information, advice and emotional support and so forth (Evan and Leighton, 1989).

[7] "SME clusters help minimizing five main types of financial risks: credit risk, market risk, liquidity risk, operational risk and business risk, and thus create capacity to draw credit facilities from banks and financial institutions" (QFE, 2019).

It is well-known that 'SME financing including cluster financing' is considered as a priority sector lending in most developing economies. Policymakers especially some central banks[8] have been playing notable roles by offering policy support for promoting a cluster approach in financing and incentivizing the SME sector as part of priority sector lending. It is about promoting banks and financial institutions for providing a certain portion of their loans to the priority sector of an economy like SMEs. Generally, specific targets are assigned to the banks and financial institutions to be disbursed to the preferential sector or sectors. Sometimes, these uniform targets might be problematic and challenging, thus effectiveness might be compromised with resource misallocation. 'Priority Sector Lending certifications'[9] introduced in India might help attain the policy targets of SME loan disbursement in a performing cluster in the developing countries.

2.2: Supporting the Development of Performing SME Clusters

'Geographical concentrations', 'interconnections', 'cooperation', competition are the key areas of focus in almost all definitions of the cluster.[10] SME clusters are also commonly characterized by 'linkage of the similar firms traded and untraded relationships', 'selling in same or interlinked markets' 'encompassing a set of public and private organizations like research institutions, suppliers, and providers of business services that offer specialized skills and infrastructure of value to the cluster'. "Cluster helps creating supply chain and international linkages and internationalization is vital for SMEs' contribution to economic growth" (Hessels et al. 2012). 'Attachment with the local economic and development activities' is also crucial.[11]

[8] For example, RBI instructed commercial banks to adopt a cluster-based approach for financing SMEs; alongside other forms, India experimented carbon financing for energy efficiency in SME clusters (http://www.rbi.org.in).

[9] "Priority Sector Lending Certificates is a tool for promoting comparative advantages among banks while they meet their priority sector lending obligations in India; banks with a comparative advantage in lending to the priority sector should earn priority sector lending certificates while those falling short of the target would be required to buy priority sector lending certificates." (https://en.wikipedia.org/wiki/Priority_Sector_Lending_Certificates).

[10] Porter (1998) defined cluster as a geographic concentration of mutually interconnected companies, specialized suppliers, service providers, companies working in the same fields that compete but also cooperate; In UNDP's (2005) definition, clusters are geographic concentrations of interconnected companies engaged in similar or highly related economic activities; ERIA (2014) termed clusters as regionally or locally networked set of economic agents that connect all critical economic agents necessary to drive learning, innovation and competitiveness.

[11] Attachment with local economic activities and development has been found to be crucial for performing clusters (UNCTAD, 1994).

Differentials in opinions and changes in the perceptions with the changing circumstances are well recognized regarding cluster formation. The meaning of 'geographic proximity' is a contested issue in cluster research and policy, and opinions vary as to whether proximate means within 'driving distance', a city, a province/state or even a nation[12]. Sippitt (2013) opines that SME clusters are not only about geography and proximity of cluster businesses to a number of support networks, and are no longer a pre-requisite for cluster concept. However, the benefits of physical proximity cannot be denied.[13]

Based on the formation process, SME clusters may be categorized into a natural cluster (like electronics cluster at Silicon Valley) that spontaneously grows and government-created clusters (like industrial parks and export processing economic zones) that are induced through deliberate policy actions. Natural clusters have the advantage of having key functional elements like trust, collaboration, and tacit flow of knowledge that may not be easy through policy intervention as it takes a longer period for developing these functional elements. It might be possible to convert these interconnected SMEs into performing clusters with limited support. However, the key rationale behind the government-created cluster is the cost-effective way of providing support to a group of SMEs operating in the same sector; and these clusters are helpful to make targeted and sector-specific interventions (CMI Report, 2012).

There is no doubt that clusters in the form of simply geographical concentration may not always perform. Reasons for such under-performance include endogenous factors such as lack of trust, resistance to innovation, and the weakness of collaborative institutions (UNIDO, 2005). Evidence shows that despite the potential benefits for the enterprises, several features of performing clusters do not always emerge spontaneously, thus, policy intervention and support services are generally required for creating the right kind of collaboration and competition (Choe et al., 2011). And these intervention includes cluster creation and cluster up-gradation or streamlining (UNIDO 2005). However, access to support services is severely hampered for SMEs in developing countries and there are a lot of scopes to strengthen the institutions to promote clustering effects in these countries (UNIDO, 2010).

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[12]The benchmarking of 143 cluster organizations in seven European countries in the context of the NGP Excellence project has shown that typically 75 to 95% of the cluster participants are located within a distance of 150 kilometers from the cluster management organization, which can be considered as the "node" of the cluster (Sippitt, 2013).

[13] Modern ways of communication, particularly structured by the Internet, have made communication much easier, but nothing beats face-to-face interaction (ERIA, 2014).

It is well recognized that SMEs that are cluster-based have huge potential to facilitate successful inclusion in the growth of productivity and networks of the global value chain. The issue of clusters in SMEs is well researched in developed countries, however, most Asian developing countries are in the dark when it comes to this matter (Foghani et al, 2017). In the context of different global economies-developed[14] and developing[15], the policy approach and status of SME clusters are not very similar, and thus their importance and benefits appeared to be different (European Commission, 2019).

Allocation of adequate funds and support services are essential for performing clusters. Support services like training, marketing support, research, and innovations with the involvement of public and private entities are particularly crucial. SME clusters draw financial resources from public funds, alternative finding sources like venture capital, crowd funding, membership fees, funding by the association, NGOs, donors, etc. Intra-group financing is common in SME clusters. Bank loans, leasing, or higher purchase and their mixes are common in SME clusters as financing options (Fernando and Senad, 2018).

The necessity of greater cooperation, collective behavior by the smaller firms, contingency funds for the rainy days, and addressing environmental risks in business operations received renewed focus in the context of the Covid-19 crisis. SMEs are affected severely during the Covid-19 situation throughout the globe.[16] Published data and studies indicate clearly that most SMEs of the developing world that was performing reasonably well, have been struggling and coping with Covid-19 challenges; and the policymakers of these countries have been supporting these enterprises to turn around. Developing countries including South Asian governments initiated monetary and macro-financial

[14] In Germany, central part of innovation policy and enterprise policy were vital as a way of creating strong clusters. Generally, clusters are seen as a way of boosting competitiveness in the French economy which helps to develop growth and jobs in key markets, such as IT, bio-technology and automotive. In USA, clusters can be found around large cities, with many trying to mimic the Silicon Valley model.

[15] China has introduced a specialist division within local government for cluster development. In India, clusters are seen as a way of developing skills collectively and demonstrating the country's competitiveness internationally. Clusters are a growing trend in Latin America and Africa as a way of building competitive advantage and drawing upon expertise collectively.

[16] "According to a survey by among SMEs in 132 countries by the International Trade Centre, two-thirds of micro and small firms report that the crisis strongly affected their business operations, and one-fifth indicate the risk of shutting down permanently within three months" (ITC, 2020); "Based on several surveys in a variety of countries, indicates that between 25% and 36% of small businesses could close down permanently from the disruption in the first four months of the pandemic." (McKinsey, 2020).

measures and incentivize banks to expand their lending to SMEs. Supporting and reaching SMEs, operating in differential market environments, and challenges became extremely difficult in this Covid-19 situation. It is much easier for policymakers to understand the need and challenges of the smaller firms operating as an interconnected group and reach out in a crisis. From the firms' perspective, clusters offer opportunities to cooperate, work together, and raise voices together in an emergency. Cluster development strategy is expected to come up with greater vigor in the new normal where technology, innovation, contingency arrangement, and environmental risk mitigation efforts are expected to be integrated strongly with that of the traditional criteria of cluster identification and assessment.

2.3: Identifying Performing Cluster for Effective Financing: Status, Performance, and Level

Identification of the status, performance and level would indicate whether a geographically concentrated group of SMEs should be considered as a 'Performing SME Cluster' or not. An updated version of the indicative Assessment Model suggested (Habib et. al, 2016) for measuring SME cluster Status (figure-2.1), Cluster Performance (figure-2.2), and Cluster Level (figure-2.3) might be useful in this context. The Assessment Model offers some prerequisites that can ensure the possibility of better performance, and based on the performance criteria, the development level of the cluster may be identified.

Figure-2.1: Cluster Status

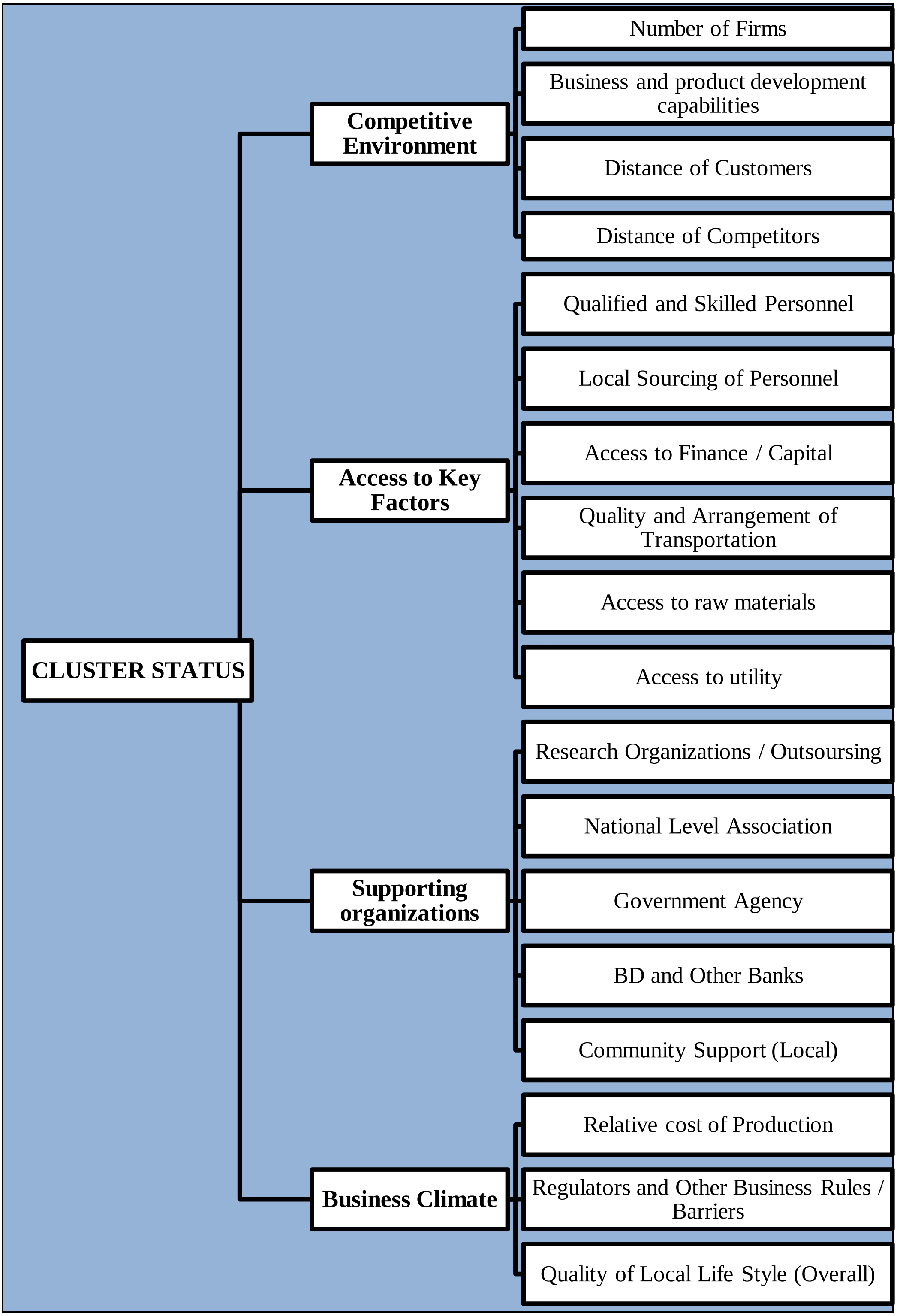


Figure-2.2: Cluster Performance

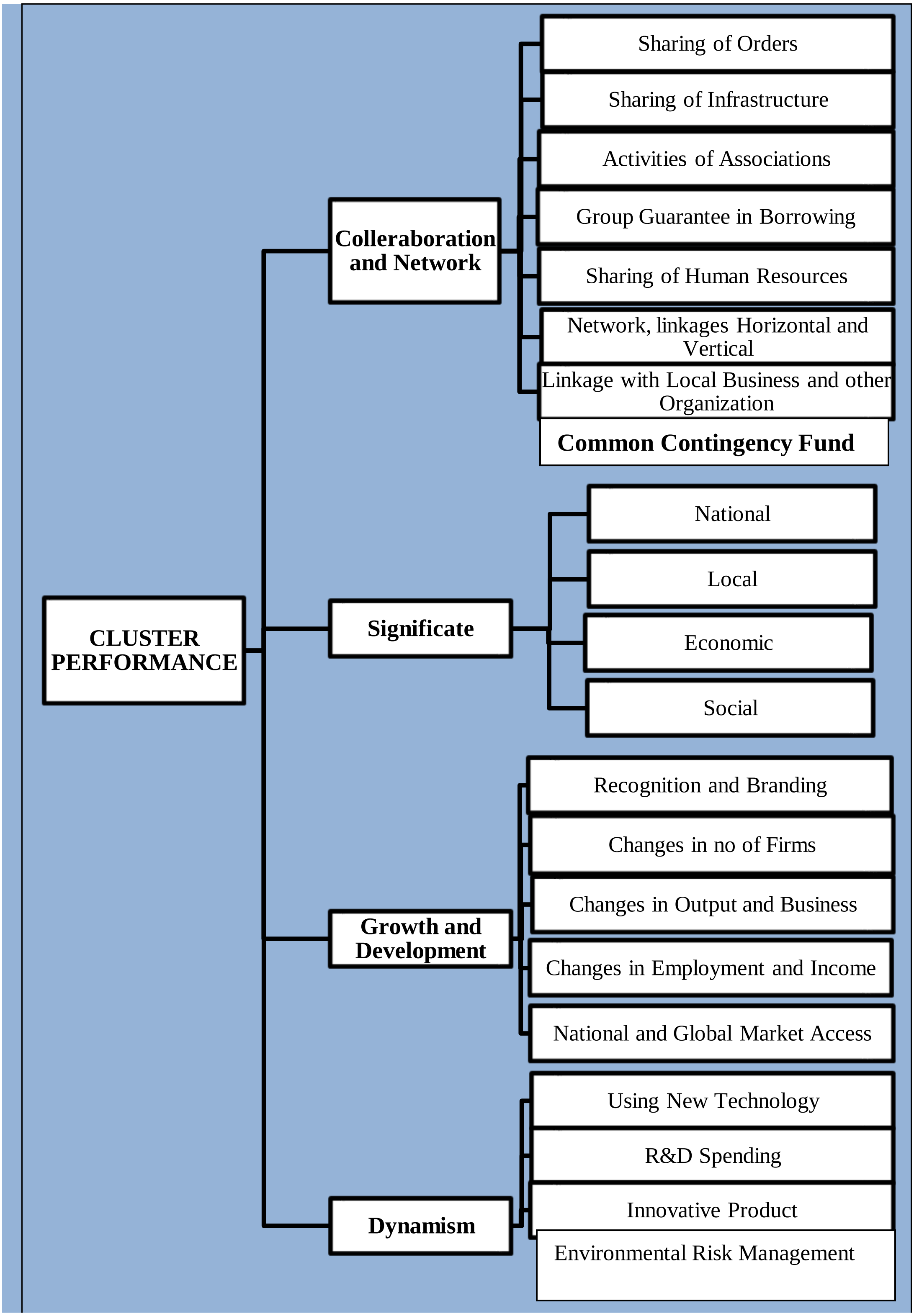
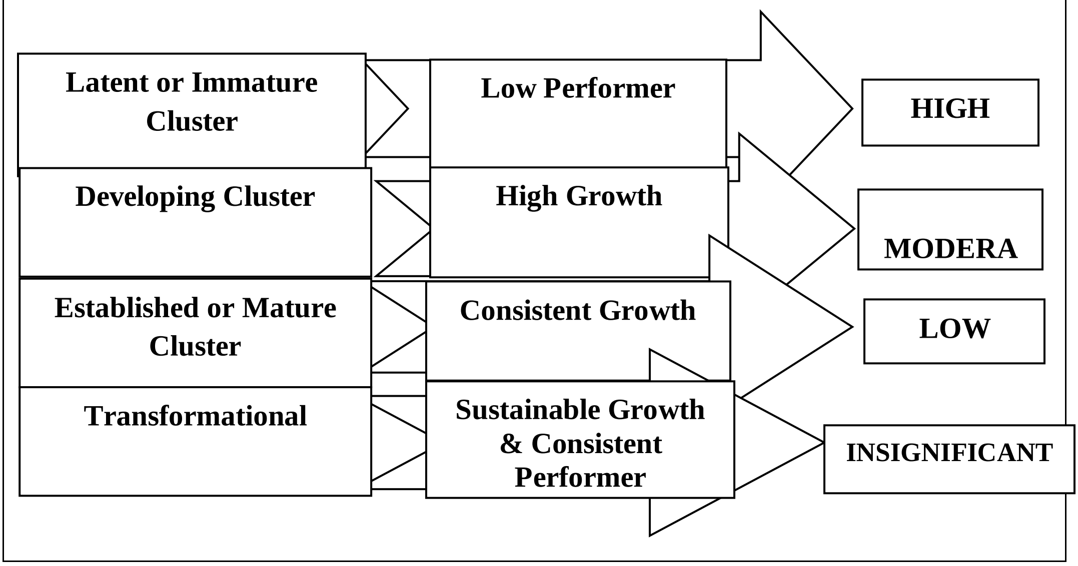


Figure 2.3: Cluster Level and Risks in Financing



The levels are crucial to identify right and effective intervention. According to the Assessment Model, SMEs levels may be categorized into Latent or Immature Cluster; Developing or Growing Cluster; Established or Mature Cluster; and Transformational Cluster.

A Latent or Immature cluster indicates several SMEs that begin to cooperate around a core activity and realize common opportunities through their linkages. This is characterized by low critical mass, low identity, low linkages, low level of growth, and dynamism. In a Developing or Growing cluster, a new set of actors in the same or related activities emerged or are attracted to the region, and new linkages are developed. The cluster started receiving importance to the local and regional economy. Formal or informal institutes for collaboration appeared by offering common promotional activities and other supports that already started pushing the growth and output of the SMEs. In the case of an Established or Mature cluster, a certain critical mass is reached, and relations outside of the cluster are strengthened. The types of clusters are characterized by high identity, high linkages, high innovation, high growth, and competition, established importance at the regional and national levels. To survive, the cluster must avoid stagnation and decay. Transformational clusters change with their markets, technologies, and processes. A sample application of the Assessment model is given (Figure 2.4) as follows (based on Habib et. al, 2016).

Figure 2.4: Application of the Assessment Model
Name: Rice Milling Cluster, Phulhat, Dinajpur

In the Phulhat BSCIC area of Dinajpur Sadar, a rice milling cluster has been identified. The total number of operating units is 500. These mills use paddy as key raw material to produce rice. The raw materials are mostly procured locally. The total amount of annual turnover stood at around BDT300 million.

Cluster Status

Competitive Environment

Number of Firms	Total 500 manufacturing firms, Auto 100, Husking 400.
Business and product development capabilities	No evidence
Distance of Customers	Customers are located in Dhaka, Chittagong, Faridpur, etc.
Distance of Competitors	Competitors are locally concentrated
Area/ locality	Competitions are amongst the mills in Dinajpur district and adjacent areas; face competition from Indian rice

Access to Key Factors

Qualified and skilled personnel	About 60% unskilled and 40% skilled
Cost of Labor	Relatively low
Local sourcing of personnel	80% local
Access to finance/capital	Satisfactory, banks are ready to finance appropriate customers
Quality and arrangement of transportation	Available
Access to raw materials	Available; Mostly collected from local sources and adjacent districts like Noagoan, Bogra, ChapaiNababgonj.
Access to utility	Available; face difficulty during load shading
Land/ accommodation	Available. Huge scope for expansion

Supporting organizations

Research organizations/outsourcing	No such formal initiatives are evident
National level association	DinajpurZilla Rice Mill Owners' Association but evidence of limited activity.
Government agency	No such instances are evident.
International agency	No
BB and other banks	Bangladesh Bank, Janata Bank, Agrani Bank, National Bank, Pubali Bank, etc.
NGO/MFI/Multipurpose	Not visible
Community support (local)	Available

Business Climate

Relative cost of production	High than the imported rice from India
Regulators and other business rules/barriers	The threat of imported rice; problem in marketing and selling.
Quality of local lifestyle (overall)	Good

Cluster Performance

Collaboration and Network

Sharing of Orders	No evidence
Sharing of Infrastructure	No evidence
Activities of Associations	On a limited scale.
Group Guarantee in Borrowing	No
Sharing of Human Resources	No such arrangement is evident
Linkages Horizontal and Vertical	Yes, Linkage between local & national traders with the manufacturers
Linkage with Local Business and other Organizations	Available, some reputed brands like PRAN, ACI, etc. give orders to them.
Emergency & Contingency Fund	No

Significance

National	Meets huge amount of demand for Rice in the country
Local	Offers employment, income.
Economic	employment, income, export, support agriculture, ensure economic growth
Social	Better living standards for the local people and offer small businesses to local people like trading.

Growth and Development

Recognition and Branding	They have their branding
Changes in no of Firms	Auto Increasing but husking decreasing
Changes in Output and Business	Decreasing
Changes in Employment and Income	Increasing
National and Global Market Access	Mostly national but the potential of export

Dynamism

Using New Technology	Yes (Auto rice milling)
R&D Spending	Not at all
Innovative Product Development	No mentionable evidence was found.
Environmental Risk Management	No deliberate attempt

Level of the Cluster

Based on the gathered information, it can be concluded that the cluster has potential but currently most of the traditional mills are facing difficulties. Activities of the local level association are limited and very limited collaboration among firms. Adequate support to develop as a cluster is missing. Products are generally locally sold. Some commercial banks have been offering finance. Intervention needed.

Regarding the outcome, Habib et al (2016) applied the 'Assessment Model' in seven of the clusters (geographically concentrated manufacturing units identified by the SMEF as part of the 177 clusters) in the areas of handicrafts, light engineering, plastic, handmade carpet (Satarnaji), agro-processing (rice mill), and leather (footwear). And it was observed that most of the SME clusters of the country were immature clusters and are generally featured by the low level of cooperation and sharing; lack of linkages; absence of the use of modern technology; absence of supply chain; absence of the involvement of universities and research organizations; and absence of expenditures on research and development. The study found huge potentials for developing clusters in SME sectors.

3. Policy Issues and Market Trends of Cluster Financing in Bangladesh

The role of micro, small and medium enterprises is recognized in the context of Bangladesh. According to a recent study by the World Bank (2019), MSMEs are undoubtedly the backbone of non-farm job creation in Bangladesh, and improving access to finance for MSMEs is a fundamental challenge in the country. Among the many compelling reasons regarding why SMEs fail to realize their full potential in Bangladesh, inadequate access to finance is prominent and most commonly cited. With a limited capital base of their own and limited access to institutional financing, most SMEs rely on inefficient and highly expensive financing services from informal sources. However, efforts are on and SME financing markets are improving amid several challenges. 'High administrative cost in lending', 'lack of adequate collateral security'; and 'documentation and processing barriers', and 'lack of awareness and financial literacy' are identified as major challenges in a recent study by BIBM (Habib, et. al, 2020). According to the survey observation, 'finding easy processing, documentation, and alternative to collateral security (52%)', 'training and awareness programs especially for the women entrepreneurs (81%)' and 'evaluation of past schemes, guidelines, and success stories to formulate more focused future CMSME finance policies (23%)' are found to contribute remarkably for improving the CMSMEs credit operations by banks. Adopting a cluster approach in financing might contribute in this regard.

The government of Bangladesh has been active in promoting SMEs of Bangladesh, and lack of access to finance as a critical challenge has rightly been recognized in the policy documents. In line with its Vision 2021, the government of Bangladesh has been working to improve MSMEs' access to finance and financing gap[17] through multiple channels. 'Increasing Scope of Access to Finance in SME sector' (strategic goal-2 with tools)[18], and 'SME Cluster-based Enterprises Network development and expansion' (strategic goal-5 with tools)[19] have been identified as part of the strategic goals with certain specific tools in the SME Policy 2019 of the government of Bangladesh.

Regarding institutional arrangement, SMEF has particularly been involved in promoting SMEs and has also undertaken some notable measures in the SME cluster development. As an initial effort of cluster identification and mapping, SMEF conducted a survey and identified 177 SME clusters throughout the country based on a specific definition and criteria[20] that mainly include clusters in the areas of rice milling, handicrafts, light engineering, Jamdani, Starangi, shoe, and plastic (Table 3.1). These clusters have evolved without any government/non-government direct patronization i.e. none of these clusters were developed by any organization and are naturally grown due to the comparative advantage, locational advantage, etc. Following the publication of the report, over the years, SMEF conducted a need assessment of 71 clusters

[17] "Access to formal finance by MSMEs is limited compared to the average for the South Asia region, with an estimated financing gap of BDT 237 billion or USD2.8 billion" (World Bank, 2019).

[18] Create a sustainable and effective institutional system for enhancing access to finance for SMEs: Increase amount of credit flow to the SME sector; Support access to finance in SME related innovations and introduce `SME Bank' in the country; Strengthen existing refinancing scheme to provide SME loan at a reduced interest rate to the SMEs; Ensure easy access to credit and low interest rate of SME loan by strengthening Credit Wholesaling (CWS) program; Launch SME Credit Guarantee Fund (SME Policy, 2019 of the GoB)

[19] Special programs will be undertaken for the development of weak infrastructures like roads, power, gas, water and communication of existing BSCIC industrial estates and other SME clusters; Considering the importance of SME clusters in national economy, the following strategic tools will be adopted: Strategic Tools; Improve infrastructural facilities at BSCIC industrial estates and SME clusters; Establish Incubation Centre and Common Facilitation Centers (CFC) in industrial estates/ clusters; Arrange collateral free loan at the single digit rate of interest for the potential entrepreneurs of industrial estates/clusters; Increase efficiency and capacity of the entrepreneurs and employees; Expand cluster development and business network to meet developmental needs of clusters (SME Policy 2019 of the GoB).

[20] Products or services should be similar or homogenous; enterprises must be production or service unit including backward or forward linkage industries; at least 50 numbers of units; adjoining geographical location: villages, unions, wards, industrial estates; scattered within an area of 5 km radius (SME Cluster Report, 2013).

and visited 101 clusters listed on the report, and started working on development interventions in 2015. In 2020, the SMEF is planning to implement development interventions in 18 SME clusters (SMEF, 2020).

Table 3.1: SME Clusters Identified by the SMEF		
Name of Cluster	Total Number of Clusters	Percentage
Rice Mill	34	19.2
Handicrafts	38	21.5
Light Engineering	31	17.5
Jamdani Cluster	38	21.5
Satarangi	10	5.6
Shoe Cluster	13	7.3
Plastic	3	1.7
Source: Based on the SME Foundation Survey, 2013.		

As part of promoting SME cluster financing, SMEF selects clusters based on the priority sector mention in the Industrial Policy 2016. With mutual understanding and by a formal offer from the Banks & NBFIs, SMEF selects Partner Financing Institution (PFIs) and a formal agreement is signed mentioning the detailed terms and conditions. Officials from SME Foundation physically monitor the beneficiary enterprises and get monthly reports from PFIs on disbursement and repayment. PFIs shoulder the credit risk. Under the wholesale program, SMEF provided BDT 92 crore loan among 1857 entrepreneurs under 31 clusters through 12 banks/NBFIs[21] of which 1345 were male entrepreneurs and 512 females.[22] BB signed a loan agreement of BDT 50 crore with the SMEF to expand its wholesale program. However, the volume of disbursement remained insignificant.[23]

'Financing arrangement' is an integral component and prerequisite of sustainable SME development. BB has been very active on this front and a separate department (SMESPD) has vigorously been involved in guiding, supporting, funding, and monitoring SME financing. It has also been part of SME entrepreneurship development and working with other government entities and donor agencies. For the first time in Bangladesh, an indicative target

[21] Mutual Trust Bank, NCC Bank, Eastern Bank, Trust Bank, Bank Asia, Dhaka Bank, Brac Bank, NRB Bank, United Commercial Bank, South East Bank, Midas Financing and IDLC Finance.

[22] The Business Standard, October 27, 2020: tbsnews.net

[23] In 2019, SMEF targeted to disburse BDT 1113 lac, and disbursed BDT 400 lac in the last quarter of 2019 (SMEF Source).

for SME loan disbursement has been set from 2010 by the banks and financial institutions considering SME development as one of the most important development agenda of the country. In response to the direction of the BB to promote SME women entrepreneurs, banks established separate 'Women Entrepreneurs' Dedicated Desks' with necessary and suitable manpower. Banks and financial institutions were encouraged to receive group security/social security in the SME financing by the central bank. BB also offered licenses to new branches specifically to finance the priority sectors like SME and agriculture. These SME supportive systems are directly relevant to all types of SMEs including clusters. At this moment, agent banking outlets are also serving SMEs.

As per the current BB guidance, 25 percent of the total loan disbursement by the banks/NBFIs must be in the CMSME sector by 2024. Despite a few policy directives, the SME cluster financing approach is yet to receive due impetus in the policy document of the BB. It is however a notable development that the banks and NBFIs are required to submit targets for SME financing and cluster financing separately. The targets of the SME cluster financing by the banks/NBFIs were only in the range of 6-8 percent (Table 3.2). Banks and NBFIs are required to report their quarterly disbursement along with separate cluster financing figures. Refinancing is an important source of funds for banks for CMSME financing by banks and NBFIs, however, the central bank does not consider cluster financing separately in the process of assigning refinance funds for on-lending. It is good to observe that some banks and NBFIs are in the process of finalizing separate cluster financing policies and strategies for their institutions with the support of BB and SMEF, as claimed in the FGD.

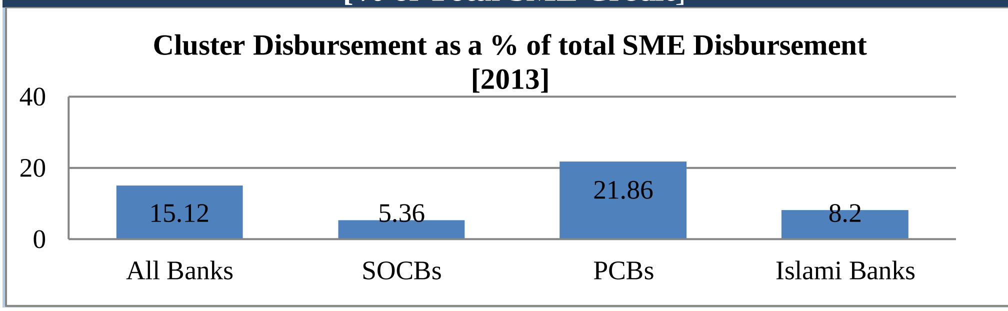
Table 3.2: SME and Cluster Financing Targets

Bank Group	CMSME Target for 2019 [BDT Crore]	SME Cluster Target for 2019 [BDT Crore]	Cluster Target as % of Total CMSME Target
SOCBs	15946.77	1290.10	8.09
SBs	4019.50	360.00	8.96
PCBs	84165.82	4703.21	5.59
Islamic Banks	60458.56	3662.60	6.06
FCBs	3099.43	229.70	7.41
Total	167690.08	10245.61	6.11

Source: Bangladesh Bank

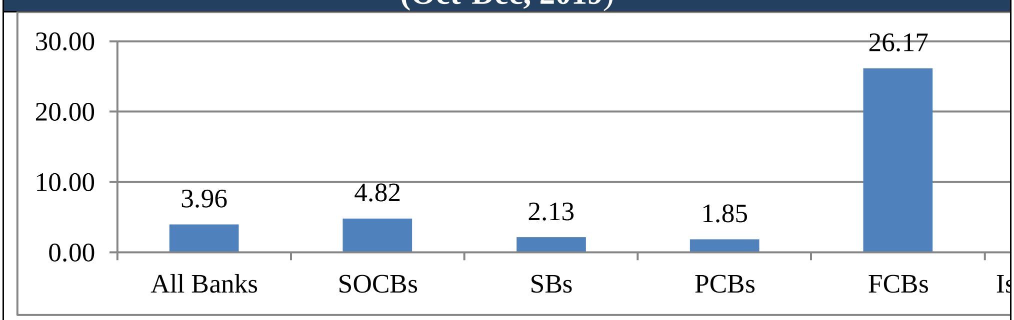
Banks and NBFIs of Bangladesh have been responding to the policy initiatives regarding SME financing. As a whole, there are a lot of areas of SME development to appreciate. However, SME cluster financing by banks and NBFIs remained insignificant though the volume increased during the last five years. As of June end 2013, of the total outstanding amount of SME financing of the banking sector only around 2 percent (less than BDT 2,000 crore) exposure was with SME clusters (Habib et. al, 2016). In the year, a considerably low proportion of banks' SME credit was disbursed to the clusters. Of the broad bank groups, the performance of PCBs was relatively better (Figure 3.1).

Figure-3.1: Disbursement and Outstanding SME Credit to the Clusters [% of Total SME Credit]



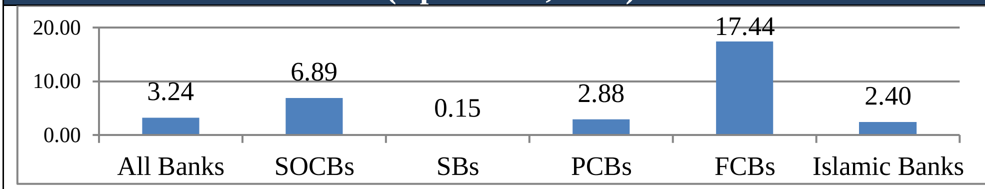
Source: Bangladesh Bank

Figure 3.2: Cluster Disbursement as % of Total SME Disbursement (Oct-Dec, 2019)



Source: Bangladesh Bank

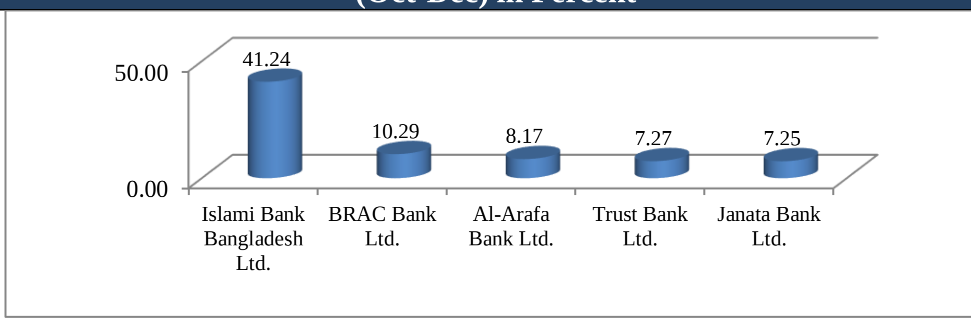
Figure 3.3: Cluster Disbursement as % of Total SME Disbursement (April-June, 2019)



Source: Bangladesh Bank

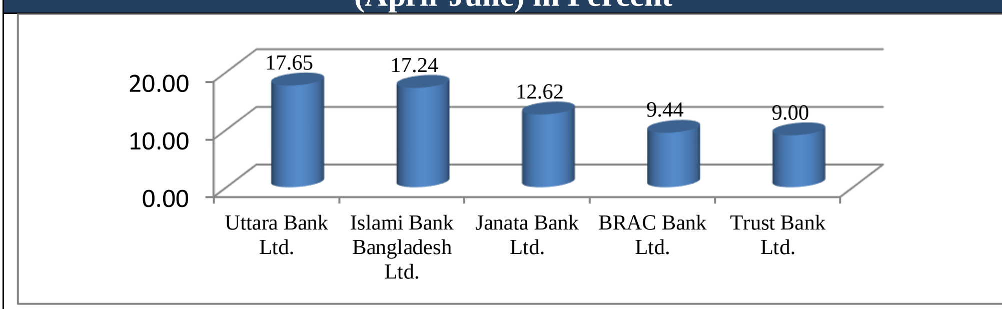
As a whole, cluster disbursement in the percentage of total SME financing decreased between 2013 and 2019 (figure 3.2). However, this practically indicates reasonably greater growth rates of SME disbursement while cluster disbursement remained slower. As the table-3.2 indicates, the proportional cluster disbursement of the FCBs appears to be higher (Figure 3.2 and 3.3). However, FCBs do not have any special focus and preferences on cluster financing, as reflected in the survey opinion.

Figure 3.4: Top 5 Banks in Cluster Loan Disbursement in 2019 (Oct-Dec) in Percent



Source: Bangaldesh Bank

Figure 3.5: Top 5 Banks in Cluster Loan Disbursement in 2019 (April-June) in Percent



Source: Bangaldesh Bank

Regarding the exposure of individual banks in SME cluster financing (in terms of credit disbursement), the distributions were much skewed. During October-December 2019 quarter, the top five banks disbursed over 70 percent of the total SME cluster loans (Figure 3.4); and the figure for the quarter April-June 2019 was over 67 percent (Figure 3.5) against other three quarters. According to the survey observation, banks/NBFIs are found to be allocating their SME cluster funds mainly to the Handicrafts (50%), Light Engineering (41%), RMG (32%), Rice Mill (27%), and Shoe (22%). This is not something intentional, rather the distribution is close to the distribution of the 177 clusters identified by the SMEF (Table 3.3).

Table 3.3: Proportion of Banks/NBFIs that have Financing in different Clusters in %

Handicrafts	50.00
Light Engineering	40.91
RMG	31.82
Rice Mill	27.27
Shoe	22.73
Satarangi	18.18
Jamdani	13.64
Plastic	13.64
Others (Hosiery, Agro-processing, Dry Fish, Bamboo & Cane, Pottery, Jewelry, etc.)	50.00
Source: Survey Data	

Cluster financing models vary in different banks and are not standardized. Based on the survey observations and discussions of the FDG, the broad classification of the cluster financing models may be categorized as SMEF Whole Sale Cluster Model; Banks/NBFIs Own Cluster Model; Regular SME Financing Model; SME Financing Model through MFIs (Table 3.4). SMEF Whole Sale Cluster Model is distinguishable from others, and relatively closer to the model of performing cluster.

Table 3.4: Cluster Financing Models of Banks followed by the Banks/NBFIs

Features	SMEF Whole Sale Cluster Model	Banks/NBFIs Own Cluster Model	Regular SME Financing Model	SME Financing through MFIs
Sources of Fund	SME Foundation	Own or BB Refinancing	Own or BB Refinancing	Own or BB Refinancing
Cluster Identification Process	Assessing market potential by both Bank and SMEF; Meeting with local association for understanding market as well as borrowers business condition; the arrangement of support services	Assessing market potential by the sales team/ relationship manager; visiting potential cluster; meeting with the local association; limited support services [same as SMEF or similar model is followed]	No Special Identification Process: Regular SME financing processes are followed	No Special Identification Process: Regular SME financing processes are followed; only funds are channeled through MFIs
Collateral	Loan with group guarantee/personal guarantee	Loan with group guarantee/personal guarantee	Collateral/ group guarantee/ personal guarantee	Collateral/ group guarantee/ personal guarantee
NPL/ Performance	Generally distinguishable from overall SME Financing	Generally distinguishable from overall SME Financing	Not distinguishable from SME Financing	Generally not distinguishable from overall SME Financing

Source: Survey and FGD

Practically, other than a few exceptions and with limited loan exposure following SMEF Whole Sale Cluster Model, banks/NBFIs hardly make a distinction between financing to the individual SME entrepreneur and the SMEs within a cluster. Cluster identification and the essential support services are very limited or missing in the lending process of cluster financing by the banks/NBFIs. However, certain SME cluster financing models by different banks and NBFIs may help draw lessons that are having different implications and outcomes (Box 4.1, 4.2, 4.3).

Box 4.1: Cluster Identification and Financing Model by the BRAC Bank Limited

BRAC Bank's process of cluster financing in collaboration with SMEF under the Credit Wholesaling Program (CWS) is pretty similar to its own SME cluster financing mechanism. With the SMEF, the bank identifies eligible members from the cluster business association as per the guidance of the SMEF. Subsequently, the bank and SMEF jointly visit potential customers for business viability. Upon satisfactory prospects, they enter into a tripartite agreement and provide financial services. Regarding their own SME financing model, BRAC bank uses its relationship officers or sales force team of the 456 unit offices throughout the country to identify clusters in the region. After identifying clusters by the field level staff regional heads and product specialists subsequently visits the clusters so that the bank can craft unique and customized products for the businesses and provide required financing. Moreover, the regional heads keep close acquaintance with cluster associations and local major players to understand the financing needs and requirements. Upon identification of unique needs the product, specialist modify or develop products as required e.g. Kuri, a product developed to cater to the Tea Gardens in the Northern Region of the country. The bank offers collateral-free loans by taking personal guarantees from a family member and another from a member of the business area. Surprisingly, the bank sometimes faces difficulties in financing decisions due to the involvement of the cluster association.

Source: BRAC Bank

Box 4.2: Cluster Identification and Financing Model by the IDLC

IDLC follows similar procedures in their SME cluster financing with or without the involvement of SMEF (excepting the subsidized rate in clusters by the SMEF). Besides, to minimize the knowledge gap and uphold the capacity of the entrepreneurs, SMEF arranges seminars and workshops which is an added advantage. From the beginning of 2020, IDLC started working on cluster financing in an organized way. Though they have a footprint in maximum clusters for a long period and the way of managing clusters' needs was under the regular product portfolio. Now they have dedicated product and credit guidelines for some clusters like light engineering, plastic industries, and dairy farms. The process IDLC follow in identifying cluster by the market survey from nearby branches within close proximity from the branch for ensuring better monitoring. If the cluster is suitable enough relationship managers (RMs) dig down further about core strengths i.e. availability of raw materials, forward and backward linkages, cooperation and competition among the entrepreneurs in that cluster, sales, cash flow, market presence, etc. of the businesses located in that cluster. Upon satisfactory outcomes, IDLC attempts to find whether there is any local business owners association. By finding an organized association the non-bank sits with the governing members of that association and communicates with them about the benefits of their products. They also persuade them to motivate other members to take financing. The governing members of the association, based on relationships, often take the responsibility to cooperate in case of default by any of the members of that association.

Source: IDLC Finance

Box 4.3: Leather Cluster Financing Confronting Challenges by the Janata Bank Limited

In 2010, Hazaribug and Siddikbazar Leather cluster financed by Janata Bank Limited under a refinancing scheme to promote entrepreneurs as the exporter. They had 7 entrepreneurs in Hazaribug and 22 entrepreneurs in Siddikbazar. The bank offered an unsecured loan with group guarantees. The entrepreneurs of Hazaribug have the technological support to process their products whereas the entrepreneurs of Siddikbazar were skilled enough by making their own hand. As financial support, the bank sanctioned BDT 3 crore in total as cash credit (CC) facility, out of which BDT 72 lac was for the entrepreneurs of Hazaribug. After that, as per Govt. decision, the factories shifted from the area to Paiti, Demra at Common Facility Centre (CFC). The shifting did not work for the businesses, and the loan became classified in 2012. Now, the bank has financing with only five entrepreneurs amounting to BDT 92 lac. The recovery rate is about 85 percent.

Source: Janata Bank Limited

Banks and NBFIs have successful and challenging cases of cluster financing. These success/challenging cases (4.4, 4.5, 4.6, 4.7, 4.8, 4.9, 4.10) might help draw lessons, and these may also be replicated by other banks and financial institutions in different identified clusters.

Box 4.4: Success of Hosiery Cluster Financing by BRAC Bank Limited

The hosiery cluster of Gobindagonj, Gaibandha flourished over the past 70 years in the area. The cluster meets a sizeable domestic demand for sweaters, cardigans, warm clothes for children, blankets, caps, etc. The cluster employs more than 100 thousand workers in hundreds of factories. To catalyze the demand of the cluster BRAC bank and SME Foundation signed an agreement to provide SME loans to hosiery entrepreneurs in 2018. To date, the bank has successfully financed about 132 firms amounting BDT around 7 crore. The entrepreneurs can avail of loans ranging from Tk. 50,000 to Tk 1,500,000 without any collateral. The amount outstanding is about BDT 3 crore. The recovery rate of the cluster is 100 percent. One unique feature of the cluster financing approach of the bank is that they have unique customized products for every cluster.

Source: BRAC Bank Limited

Box 4.5: Success of IDLC with the Light Engineering Cluster Finance

In the year 2010, IDLC initiated financing in the light engineering cluster in Bogura. They sanctioned about BDT 2.5 crore to 3 to 4 entrepreneurs. At present, the number of borrowers of the cluster is around 45 and the amount outstanding is about BDT 41 crore. The bank financed around BDT 60 crore mostly in machinery under a lease arrangement. Besides, they practice Hypothecation and take personal guarantees. Some entrepreneurs have mortgage coverage as well. The recovery rate of the cluster is around 98 percent. A unique feature of the cluster financing mechanism of IDLC is that they take fire insurance as a safety for the borrowers as well as the IDLC.

Source: IDLC Finance

Box 4.6: Success of Rice Milling Cluster Financing by Al Arafah Islami Bank Limited

Noagang, Madhabpur Rice Milling Cluster is one of the successful clusters financed by the Al Arafah Islami Bank Limited (AAIBL). The bank started financing this cluster in 2015 to one borrower and disbursed about BDT 8 lac initially whereas the present number of borrowers is thirty-plus and the amount outstanding is about BDT 40 crore. The bank channelizes around BDT 20 crore mostly in the form of working capital financing. The bank offers secured credit with few exceptions. The bank takes a group guarantee on a limited scale. The recovery rate from the cluster is about 95 percent. Moreover, the bank is planning to move forward in the cluster through MFS and agent outlets to minimize their cost structure.

Source: Al Arafah Islami Bank

Box 4.7: Financing Women Entrepreneurs in the Handicraft Cluster by National Bank Limited

National Bank Limited Jamalpur branch is offering financial support to a good number of women entrepreneurs who are involved in the handicraft business. They were inspired to finance them in 2009 by observing the constraints they were facing, some of them used to borrow a very poor amount from NGO’s with high-interest rates. They started the program with inspiration from the Bangladesh Bank and with the initiative of the then top management of the bank. The bank started group financing under the group guarantee system where they have disbursed about BDT 6 crore in a total of 70 groups. Besides, the bank financed a total volume of BDT 20 crore to about 1239 entrepreneurs and thereby generated 13000 employments in the area. The recovery rate of the cluster is around 97 percent.

Source: National Bank Limited

Box: 4.8 Success of Textile and Weaving Cluster Financing by United Commercial Bank Limited

Narsingdhi district is popular for the Textile and Weaving industry cluster as identified by SME Foundation. In Madhabdi, Narsingdi, UCBL financed up to BDT 400 crore in 2012. The bank also has undertaken different initiatives for developing and maintaining the cluster. They educated the people who are doing a textile business with different business knowledge and introduce them to the modern business process. The bank also offered different training initiatives related to business expansion, product marketing, and network building. At present, the bank has disbursed BDT 39 crore up to December 2019. The bank offers secured credit and the financing procedure has been customized according to the business needs of the cluster. The recovery rate of the cluster is about 93.64 percent.

Source: United Commercial Bank Limited

Box 4.9: Specialized Cloth Cluster Financing using Agents by Bank Asia Limited

In Adamdighi, Bogura Bank Asia limited initiated to finance in specialized clothe cluster at the concessional interest rate in 2018. The total number of 100 entrepreneurs is financed amounting to around BDT 4 crore. The recovery rate of the cluster is 100 percent. Previously, one SOCB and one PCB were financed in the cluster but due to the high rate of interest majority of the entrepreneurs failed to repay. However, Bank Asia limited successfully managed the hurdle because of the collaboration with the SME Foundation. Besides, a noteworthy step the bank has incorporated in the cluster financing model is the use of agent points to monitor the cluster as well as collection facilitation. The bank mentions that they can become successful only in cluster financing through the use of agent points as the branch is mostly far away from the clusters throughout the country.

Source: Bank Asia Limited

Box 4.10: Nakshi Kantha Cluster Financing by Trust Bank Limited

Jashore is popular for its Nakshi Kantha. When it comes to stitching similar styles are found in other areas of the country. In this traditional cluster, Trust Bank Limited financed in association with SME Foundation. Initially, in 2013, the bank sanctioned about BDT 1.75 crore to 200 entrepreneurs. The cluster was performing well except in 2016-17 when the NPL stood at 37 percent. Subsequently, some entrepreneurs failed to repay the loan and could not continue with the process. The major reasons are: only bank monitoring is not sufficient for ensuring the performance, moral hazard is a problem for group guarantee. The role of SME Foundation is at the disburse stage of the loan and if borrowers' default then the prime responsibility goes to banks, as the bank claimed.

Source: Trust Bank Limited

FGDs with the representative of banks/NBFIs came up with certain challenges that they are confronting and way forwards for successful cluster financing activities in near future (Box 4.11, and 4.12).

Box 4.11: Challenges of Cluster Financing: Opinions of Banks/NBFIs

1. Supervision and monitoring cost are high in the case of SME as well as cluster financing as opined by all the participants of the FGD.
2. Most of the participants (80%) expressed that the mindset of the borrowers in differentiating cluster financing is a big challenge.
3. 40% of the experts mentioned that the lack of knowledge regarding the concept of cluster financing is an impediment.
4. Sometimes (35%) banks face problems in the lending decision because of the interference of the market association.
5. 20% of the respondents identified the regulatory bar as a problem for availing of the refinancing facility in case of a loan without collateral.
6. Lack of interest in the top management in cluster financing is a challenge as stated by many participants (70%).
7. Some of the participants opined the Non-availability of the trade license as difficulty in cluster financing.
8. 55% of participants expressed that a limited branch network or local setup for monitoring the borrower also hampers the cluster financing as it affects the recovery

Source: Based on FGD

Box 4.12: Suggestions for Effective Cluster Financing: Opinions of Banks/NBFIs

1. Banks can utilize the agent banking model in case of reducing monitoring and supervision cost. Introducing a technology-based solution can also help in this regard as expressed by many participants (90%).
2. Almost all the participants expressed that an awareness program should be arranged to change the mindset of the borrowers.
3. 60% of the respondents are in favor of arranging appropriate training for minimizing the knowledge gap of the field level bank officials
4. Financing in the various cluster may help to ensure the overall economic development of the country. Top management can play the role of catalyst in this regard as the NPL of the sector is relatively lower than that of the corporate.

Source: Based on FGD

4. Observations and Recommendations

***One*,** It is the performing clusters that contribute better. A generic SME strategy may not work for performing cluster development. Cluster development and cluster financing received adequate policy attention in the country to date. SMEF performed the primary and essential job of identification of clusters based on the geographical proximity of SMEs of all sectors, and now focusing on interventions. SMEF's cluster identifications and interventions are the foundation for undertaking effective cluster development strategies in different regions of Bangladesh. For draw benefits, it is time for the up-gradation of the cluster mapping by identifying current status, performance, and levels. To perform the job, SMEF, other relevant government agencies, SMESPD of the BB, specialists, and experts of the areas are required to coordinate for formulating and adopting appropriate strategies.

***Two*,** Despite some success stories, banks and NBFIs are yet to adopt an effective cluster financing approach. SMESPD may think of allocating special attention to supporting and incentivizing cluster financing by banks and NBFIs. A separate cell and strategy are needed in the SMESPD to handle this special type of SME financing model. Special cluster development and financing models for women entrepreneurs might be contributory in handling even greater challenges of SME financing to the women SME entrepreneurs. Banks and NBFIs should be required to formulate bank-specific SME cluster financing policy and strategy to effectively implement their SME cluster financing targets, and regular reporting with data on their cluster financing, business models, and financial performance for better monitoring and support. A minimum portion of SME cluster financing targets may be imposed by the central bank with a tagged incentive structure.

***Three*,** The volume of cluster financing by banks and NBFIs remained insignificant of the total, and in most instances, these financing activities are hardly distinguishable from that of the regular SME financing. This special approach of financing may have similarities but should not be diluted with the regular form of SME financing, and banks and NBFIs should handle cluster financing under the specific and customized policy and strategic guidelines using a separate desk. Alongside policy support, banks and NBFIs need to invest to streamline their SME clusters to draw maximum benefits.

Identification of the status, performance, and level should be the primary job to lend to a particular cluster. Based on the given criteria, banks and NBFIs may assign a score and standardize the assessment model for the selection of the performing cluster in the process of financing.

Four, Involvement of additional costs and efforts may be discouraging for banks and NBFI in undertaking SME financing. This is even more obvious for SME cluster financing. Bangladesh Bank has significantly expanded its CSR activities in recent years, with pledging financial support to several projects. Besides, BB has been encouraging and offering incentives to banks and financial institutions to undertake CSR activities to attain sustainable development. To support cluster financing, the involvement of banks' additional costs (not the financing part) might be considered or counted as their CSR activities. This may be an encouraging factor for banks to undertake cluster promotion and financing. Even after ensuring all the policy support and incentives, banks and NBFIs have their comfort zones and financing areas. All banks may not have adequate capacity and advantages in fulfilling SME cluster financing targets effectively. In such a scenario, a provision or model in line with the 'priority sector lending certificate' might be contributory both for the banks/NBFIs and the policymakers of the country.

Finally, cluster development and the associated financing is a multi-stakeholder approach where policy and operational coordination would help to stimulate innovations, manage resources efficiently, and can help environmental and social challenges. All stakeholders need to realize that if SME financing is a 'Credit plus approach' then SME cluster financing has to be a 'Credit Plus Plus approach' that requires greater investments and efforts, and the benefits are also much higher and sustainable.

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Appendix – 1

List of Banks Responded to the Questionnaire

Sl. No.	Bank Name
1.	AB Bank Limited
2.	Agrani Bank Limited
3.	Al Arafah Islami Bank Limited
4.	Bangladesh Krishi Bank
5.	Bank Asia Limited
6.	BRAC Bank Limited
7.	Commercial Bank of Ceylon PLC
8.	Eastern Bank Limited
9.	First Security Islami Bank Limited
10.	Islami Bank Bangladesh Limited
11.	IDLC Finance Limited
12.	IFIC Bank Limited
13.	Janata Bank Limited
14.	Meghna Bank Limited
15.	Midland Bank Limited
16.	Mutual Trust Bank Limited
17.	National Bank Limited
18.	ONE Bank Limited
19.	Prime Bank Limited
20.	Premier Bank Limited
21.	Rajshahi Krishi Unnayan Bank
22.	Social Islami Bank Limited
23.	Sonali Bank Limited
24.	Southeast Bank Limited
25.	State Bank of India
26.	Standard Bank Limited
27.	Standard Chartered Bank
28.	Trust Bank Limited
29.	United Commercial Bank Limited

Appendix – 2

Questionnaire for the Research Workshop on ‘Are Banks Engaged in SME Cluster Financing?’

Name:		
Designation:		
Bank:		
Department / Division / Unit:		
Cell :	**Landline :**	**Email :**

1. Please give the following information regarding your SME credit portfolio.

	Target (2019)	**Disbursement**	
		2019 (April-June)	**2019 (October-December)**
Total CMSME Finance (in Crore TK.)			
Total SME Cluster Finance (in Crore TK.)			

2. What are the existing SME cluster financing techniques of your bank? ____

3. What are the methods you use to identify SME cluster?

4. Please mention the localities where you have cluster arrangement?

District	**Locality**	**Cluster Name**

5. Please describe the cluster arrangement in detail.

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6. What are the challenges that you are facing while financing to SME cluster?

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7. What are the possible suggestions to overcome the above-mentioned challenges?

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Appendix – 3

List of participants in Focus Group Discussion (FGD)

Sl. No.	Name	Bank Name
1.	Md. Abdul Karim Miah	Agrani Bank Limited
2.	Imrul Hasan	United Commercial Bank Limited
3.	Md. Kamrul Hasan	One Bank Limited
4.	Md. Khorshed Anwar	One Bank Limited
5.	Raffiqul Islam	Islami Bank Bangladesh Limited
6.	N. M. Shaheed Ullah	Islami Bank Bangladesh Limited
7.	Masuma Begum	Islami Bank Bangladesh Limited
8.	Shaheed	Islami Bank Bangladesh Limited
9.	Kamrul Islam	IDLC Finance
10.	Aolad Hossain	First Security Islami Bank Limited
11.	Riazul	Premier Bank
12.	Shubhasish Dey	State Bank of India
13.	Hosneara Shikder	National Bank Limited
14.	Md. Mashiur Rahman	Standard Bank
15.	Abdus Sabur	Bangladesh Krishi Bank
16.	Shawkat Alam	Standard Chartered Bank
17.	Abdul Gofur	Janata Bank Limited
18.	Monzur Hossain	Al-Arafah Islami Bank Limited
19.	Syed Abdul Momen	BRAC Bank Limited
20.	Md. Sajed	BRAC Bank Limited
21.	Ishtiaque Ahmed Rahat	Bank Asia Limited
22.	Retanti Talukder	Trust Bank Limited
23.	Kazi Mohammad Selim	Mutual Trust Bank Limited

Appendix – 4

Questions asked in the Focus Group Discussion (FGD)

1. What is the way to fix cluster financing target of your bank?

2. Is there any policy/strategy of your bank regarding cluster financing?

3. How do you segregate cluster financing process with that of SME financing process?

4. Is there any difference in cluster financing and SME financing in terms of collateral arrangement, cost structure, performance, etc.?

5. What are the challenges you are facing while financing to SME cluster?

6. What are the possible suggestions you recommend to overcome the challenges?

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