Chapter 7

Working Capital Financing by Banks in Small Enterprises:
Problems and Challenges for Bangladesh

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ABSTRACT

Among all the economic players, small enterprises (SEs), by number, dominate the whole world business segment. However, it is a very common problem for SEs, in every economy either developed or developing, to get access into formal financial sector. Working capital can be treated as the life blood for SEs to be operated. But unfortunately, most of the small enterprises face serious problem while obtaining such loan from banks. On the other hand, banks face a lot of problems to finance working capital to SEs. Therefore, this chapter intends to identify the problems faced by SEs in obtaining and by banks while financing working capital. A total of 413 small enterprises were interviewed through a structured questionnaire administrated directly by the researchers and selected purposively from the capital city (Dhaka) of Bangladesh. The major findings indicate that about 72% small enterprises got the access into banks for working capital loan although all of them face a lot of problems while obtaining such loan from banks. To identify the problems and challenges faced by banks while financing working capital to SEs, 34 commercial banks' officials working in SME department were interviewed through questionnaire and selected purposively based on their high involvement into SME sector lending. Bankers encountered different problems and challenges related to working capital financing in SEs. Based on the survey findings, a good number of solutions have been formulated for policy initiatives.

INTRODUCTION

Among all the economic players, small enterprises (SEs), by number, dominate the whole world business segment (EdinburghGroup, 2013). In consideration of the contribution to the world GDP, it varies from 16% (in low income countries) to 51% in high income countries (EdinburghGroup, 2013). In terms of employment creation worldwide, research suggests that small and medium enterprises are the dominant contributors in all the regions. Beyond the contribution towards the GDP and employment, small businesses are also significant for the society for building social network, ensuring life standard of poor people, export earnings, reducing social unrest, creating new entrepreneurs, satisfying consumers' needs with competitive price, fulfilling the requirements of many large businesses and others (Mamun, Hossain & Mizan, 2012).

Small and medium enterprises are considered as the backbone of the economies of Asia region. During 2007–2012, on an average SMEs account for 98% of all enterprises and constitutes more than 66% of the national labor force in Asia (ADB, 2013). This report also reveals that in the same period the sector contributed 38% (on average) of the GDP or manufacturing value added and 30% total export values. SEs are also the backbone of Bangladesh economy and their contributions can reduce poverty to a satisfactory level by creating jobs for the skilled and unskilled manpower in this sector. In Bangladesh, SME sector contribute 25% to the GDP, about 40% of gross manufacturing output, account for 90% of the private sector enterprises and about 70% to 80% of the non-agricultural workforce working in the sector which is around 25% of the country's total labor force (Alo, 2014, Februry 7).

Bangladesh economy is characterized by high population, low per capita income, high level of unemployment and underemployment, mass poverty and high income disparity (Mamun, Hossain & Mizan, 2012). In these circumstances, higher growth of SEs which is treated as an engine for economic growth and machine for job creation may reduce poverty of Bangladesh to a satisfactory level by creating employment for the skilled and unskilled manpower in this sector. Despite the high potentiality and remarkable contributions towards the economy, still the sector is facing severe financing problems almost all the Asian countries, along with other multidimensional problems depending on the countries, which are hindering their survival and jeopardizing potentiality of future growth.

As part of SEs financing requirements, working capital (WC) plays a significant role in the success of SEs. According to Kwenda (2015), working capital can be regarded as the reservoir of internal financial resources and can be used for supporting the growth or expansion of business. WC is that portion of a firm's capital which is employed in short term operations. It is a significant issue during financial decision making as this is a part of the investment in total assets that requires an appropriate financing investment (Bhunia, 2010). Although working capital problems can be experienced by organizations of any size, it is usually small businesses that experience most problems, especially during periods of start-up and expansion (McCosker, 2000). Too little of working capital will result in cash flow problem, failing to pay suppliers on time and being unable to claim discounts for prompt payment. On the other hand, too much resource tied-up in working capital will earn a lower-than-expected rate of return on capital employed. Proper management of working capital is important to guard the financing constraints (Ding, Guariglia & Knight, 2013). As a result, optimum investment in working capital is the precondition for the small business success. Therefore, Peel, Wilson and Howorth (2000) suggest that an efficient working capital management is particularly important for small and medium-sized firms due to the greater difficulties they have in obtaining funding on the long-term capital markets and, hence, their greater dependence on trade credit and bank credit as major sources of debt.

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