SME Finance: A Comparative Study of European, Japan and US Model: What Bangladesh should do to Achieve Sustainable Development Goal 9?

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Abstract

Small and medium enterprises (SME) finance is much more talking issue in emerging economies. The US-led entrepreneurial finance model considered as a benchmark for innovative start-up finance. Similarly, Japanese "keiretsu" and "zaibatsu" model considered as touchstone to revival of Japanese economy as well as SMEs after World War II. This paper discussed about their models with two perspectives such as institutionalization of SMEs and SMEs financing tools. Bangladesh has an ambitious target to enter into high income economy club within 2041and the country also needs to achieve the SDG by 2030. Therefore, it is essential to fix an appropriate model to institutionalization of SMEs and develop SME finance tools which will helps to smooth graduation from LDC in 2024 and also achieve goal 9 of SDG. This paper finds some ways for Bangladesh for achieving SGD 9 which will promote entrepreneurial and SME finance of the country.

Keywords: SME finance, Keiretsu, Zaibatsu, Cluster development, SDG

Introduction

Small and medium enterprises (SME) finance is a much talked issue in recent days especially both in developed and developing economies. The trends and problems are different in each region. Therefore the approaches to address the solution are different in nature. Bangladesh, densely populated developing economies in South Asia, which targeted is to become developed nation within 2041, which will also a year of celebration of her 70th independence. In this paper we will attempt to address the definition of Small business, its importance and role in the economy in the first section. In the second to sixth section of this paper we discussed about economic history and evolution of SME finance in European Union, Japan, the US and Bangladesh. Finally we discussed the sustainable development goal 9 in last section and proposed some recommendation to Bangladesh economies considering our discussion in the entire article.

1. SME definition, importance and role in economy

Brihsa and Pula (2015) mentioned the UNIDO's eight key indicators that separate SME from large enterprise and these are management, personal, organization, sales, buyers relations, production, research and development and finance. Bolton (1971) mentioned three yardsticks such as small market share, no separation of management and ownership and sole responsibility for recognizing small business. Bannock (2005) defines small firms with some unique features comparing with large firms such as: heterogeneity and rationality, ownership and family business, multiple business ownership, motivation, legal form, self-employment productivity and profitability, earnings of owners and employees, births and deaths rate, risk and survival, exports and internationalization. According to US Small Business Administration (SBA), small business refers any individual business that employ <500 employees and a specific annual turnover (based on industry) (SBA 2017). European commission also use staff head count and annual turnover or size of balance sheet to define SME (European Commission, 2005). Japan also uses registered capital and number of employed employees to classify SME and its different segment (Japan SME Act 1999). As per National Industrial policy 2016 of Bangladesh, the definition of SME based on employees employed and fixed assets which is provided in the table 1.1

Table 1.1 Definition of Small and Medium enterprises in Bangladesh

Enterprises	Sector	Fixed asset (excluding land and buildings) in BDT Million	Employees (person)
Small enterprises	Service	1 – 20	16-50
	Manufacturing	7.5 - 150	31-120
	Trade	1 -20	16-50
Medium Enterprises	Service	20 - 300	51-120
	Manufacturing	150-500	121-300 (In RMG 1000)
	Trade	20 - 300	51-120

(Source: National Industrial Policy , 2016)

A small business helps to uplift economic growth. Coase (1937) referred that the transaction cost of large organization can reduce productivity. He argued "the operation of market cost is something and by forming an organization and allowing some authority (an entrepreneur) to direct the resources, certain marketing cost can be saved" (pp.392). Schumpeter (1934), also refers the creative destruction as a feature of entrepreneurship and stressed on innovative initiatives for economic growth. Schumpeter (1942, pp. 83), documented that, new market, new process, new consumer goods and new form of organizations are the capitalist engines for economic growth. Peter F. Drucker (1985) while describing the entrepreneurship admitted that small firms are the birthplace of many US big companies like McDonald. There are a lot empirical a research also supports the mentioned statements. In addition, the role of small firm in the main stream economy is evitable from job creation to absorbing market risk. Elimam (2017) found a significant positive impact of small business on Saudi Arabian employment market while analyzing the data from the year 2005 to 2013. Cho et al. (2017) in Korea, Maksimov et al. (2017) in seven LDCs, Ibrahim and Ladan (2014) in Nigeria found SMEs positive impact on employment. Hoffmann (2011) found that US banking deregulation in 1980s was fruitful due to absorbing the risk by small firms. Kassicieh et al. (2002), Audretsch (2002) findings are also support this implication. In addition, the role of small business in knowledge economy (technological economy) in developed economics is evident in many empirical researches. Tremblay and Dossou-Yovo, (2015) in greater Montreal area, Mc Gregor and Vrazalic (2006) on Swedish e-commerce found similar notion. Sjoholm and Nannan (2010) found positive effects of Chinese small IT firms on overall Chinese IT market boom.

2.Institutionalization of SME and SME financing tools in Europe

In 2000, Feira European council adopted "European Charter for Small Enterprises" which recognized that SMEs has power to fulfill the mew market needs as well as creating new jobs. The Charter has taken ten action bound resolution to fostering European Small business. These are : (1) education for training and entrepreneurship (2) cheaper and faster startup (3) better legislation and regulation (4) availability of skills (5) improving online access (6) more out of single market (7) taxation and financial matters (8) strengthening the technological capacity of small enterprises (9) successful e-business model and top class small business support (10) develop more stronger and more effective representation of small enterprises interest both at union and national levels (EU, 2000). Formulating the Small Business Act (SBA) has provided an extra mileage to the European SMEs. It is a comprehensive policy for European SMEs that adopted on 2008 with the slogan of "think small first". The prime objectives of this act are to cut the all form of red tap procedure in SMEs growing up process. Four major priorities were set in the act and these are promoting entrepreneurship, less regulatory burden, access to finance, access to market and internationalization (SBA, 2008). European commission has formulated ten (10) principles and policy action to translate the act into practice. These ten principles and action plans are presented in the table 2.1

Table 2.1 Summarize of Small Business Act 2008

Principles No.	Themes	Policies
1	Promoting entrepreneurship	Various educational programme
2	Second chance	Support the restarter
3	Think Small First	Formulate new regulatory rules for small business
4	Responsive administrations	Establish efficient communication with member states
5	Access to public procurement	Establishing e procedure in all steps
6	Access to finance	Established a European venture capital market
7	Single Market	Easing the standard to grow up
8	Skills and Innovation	Extend the mobility of entrepreneurs and staffs
9	Turning environmental challenges into opportunities	Provide incentives for eco friendly products
10	Support to internationalization	Work to remove trade barriers outside EU

(Source: SBA, 2008)

After expiration of Lisbon agendum/strategy (2000-2010), Europe 2020 strategy (for the period 2010 to 2020) was taken to boost the entire European economy. There are five key strategic goals included in Europe 2020 strategy such as: employment, research and development, energy, education, poverty and exclusion (EU, 2016). There are specific target set in each indicators/goals and each year the progress was dully reported and discussed which are shown in the European Commission different publications and web portal. To keep our discussion in relevant topics we are not intend to discuss of this issues here. However, all initiatives are taken by European commission has reflection of Europe 2020 strategy.

As discussed earlier, the SBA act was again revisited in 2011 to reflect the Europe 2020 strategy. To implement the SBA principles no. 6 the policy initiative taken by the commission for mitigating the SMEs access to finance is presented in the table 2.2

Table 2.2 Policy initiatives to support the SMEs access to finance

Sl. no.	**Policy initiatives**	**Key implementation tools**
1	Loans and guarantee	• Provide bank loan to SMEs and guarantee to financial institutions to mitigate SME credit risk
2	Venture capital	• Formation of European venture capital fund in 2013 • Adopting Single market act in 2012
3	Business angels	• Formation of expert group • Provide all out support to angel investors
4	Growth stock market	• Flexibility in listing regulation for high growth SMEs
5	Crowd funding	• Consultation on crow funding

3. *Institutionalization of SME and SME financing tools in Japan*

Ministry of Industry and Trade (METI) was formed in 1949 with merging from eight bureaus and four agencies, to respond the post war crisis. METI was revamped from time to time and was successful to achieve its objectives. ‘The Small and Medium enterprise agency’ is one of the most important agency under METI. ‘The Small and Medium Enterprise Basic Act’ was adopted in 1963 and the act was latest amended in 1999. According to METI (2013), the basic changes in Japanese SME policy can be classified into four time-frame categories within four basic policies (basic principles, monetary policies, promotion policies and organization policies) which presented in the table 3.1. Four time-frame categories are :

1. Post war reconstruction period (1945-1955)
2. High growth period (1955-1970)
3. Stable growth period (1970-1989)
4. Transition period (1989-till)

Table 3.1 Major changes in SME policies since 1945 to till date in Japan

	1945-1955	1955-1970	1970-1989	1989-till
Basic principles	Small and Medium Enterprise Agency established (1948) Antimonopoly Act (1947)	SME Basic Act enacted (1963)		SME Basic Act revised (1999) SME Basic Act revised (2013)
Monetary policies	Shoko Chukin Bank established (1936) National Life Finance Corporation (1949) SME Credit Insurance Act (1950) Credit Guarantee Association Act (1953)	Japan Finance Corporation for Small and Medium Enterprise (1953) established Small Business Investment Company (1963)	MARUKEI (managerial improvement) loans for small businesses introduced (1973)	Japan Finance Corporation Act (2007) Shoko Chukin Bank Limited Act (2007) Credit insurance system expanded (2007) Financing support for overseas expansion (2012) Act on Mutual Relief System for the Prevention of Bankruptcies of SMEs revised (2010)
Promotion policies	-SME Consultation Centers established (1948) -SME Consultant Registration System (1953) -Blue return system (1949)	SME Modernization Promotion Act (1963) Small Enterprise Mutual Relief Projects Act (1965) Small Business Promotion Corporation established (1967)	SME Business Conversion Act (1976) SME Universities (1980)	Organization for Small and Medium Enterprises and Regional Innovation, Japan established (2004) SME New Business Activity Promotion Act (2005) SME Manufacturing Enhancement Act (2006) Small Enterprise Mutual Relief Projects Act revised (2009) Act on Special Measures for Industrial Revitalization (2009) Industrial Revitalization Act revised (2011)
Organization policies	SME Cooperatives Act (1949) Chambers of Commerce and Industry Act (1953)	SME Association Organization Act (1957) Commerce and Industry Association Act (1960) Shopping District Promotion Association Act (1962)		

(Source: METI, 2013)

From the above discussion we can conclude that Japanese SME revival process started just after world war II and the sector gets highest priority to bring the dynamism in the sector. As a result SME flourish rapidly in Japanese economy and help the heavy industries to regain its strength after severe losses in world war II.

4.Institutionalization of SME and SME financing tools in US

Basically, small business proliferation campaign re-emerge in US after adopting the Schumpeterian theory of creative destruction although during pre-colonial and colonial era, small business was dominated over large enterprises. Table 4.1 illustrates the major economic driving forces in different eras in the US. In 1953, the ‘Small Business Act’ was adopted and ‘Small Business Administration (SBA)’ was formed. Now SBA has 68 district offices in all around the America. Access to capital, entrepreneurial development, government contracting and free advocacy is the main activities of SBA (SBA, 2016). Parnell et al. (2014) found that strong SME data base helps the US SMEs to take competitive strategy and cope with uncertainty.

Table 4.1 Major economic driving forces in different eras

Sl No	Period	Economic driving forces
1	Colonial era (1607-1776)	• Agricultural product • Developed a well maintained transportation and distribution process
2	Revolutionary, early national and antebellum eras (1776-1860)	• Light manufacturing industries grow quickly and adopting technology from Britain • Federal banking system introduced
3	Reunification era (1860-1920)	• Concentration on heavy industrial manufacturing • Formation of business conglomerates • Introducing investment banking
4	War depression and war again era (1914-1946)	• Revitalizing the entire economic system federal banking systems to industrial relation
5	Post war era (1946 to the present)	• Implementation of Keynes's The General Theory • Schumpeterian "creative destruction" theory

(Adapted from Walton and Rockoff, 2002)

In addition, Venture capital (VC) plays a vibrant role in US innovative small firms to access into finance and access to capital market. From the early 1970s when the US Federal Reserve allowed the pension fund to invest in venture capital, the market got momentum. During the last three decades (1970-2000) US VC industry has invested $456 billion in approximately 27,000 companies (Dolezalek, 2009). Nearly 17,000 numbers of US ventured backed companies raised around $21.5 billion in the Q3 2017 (VC Monitor, 2017). Therefore the role of VC in United States has very important in small business finance especially innovative IT and biotech sector.

5.Bangladesh economy and SME finance review

During the British colonial period (1757-1947) Bangladesh was merged with Bengal presidencies of British India and after end of British era, it again became a part of Pakistan (as East Pakistan) till independence from Pakistan in 1971 (Gupta, 2012). Therefore, it is rationale to justify Bangladesh economy if we start our discussion from 1972 when the country actually gets its own identity and true independence from non-Bangladeshi origin statesman. Due to Multi-Fibre Arrangement (MFA) in 1973, Bangladesh get quota in exporting readymade garments in the Unites States which is milestone for exporting garments products in US in early 1980s (Khan 2010). Khan (2010) also mentioned that after liberation war, that was the first capitalist rents absorbed by banks and economy as well as and after 1990 when democracy was became institutionalized, the economic growth got momentum. As on World bank 2017 data base Bangladesh has 164.9 million population, $1480 GDP per capital and 18.5% poverty rate (World Bank,2017). Recently the ruling governmental initiatives has praised in ADB outlook 2017, "Under the Seventh Five-Year Plan, FY2016–FY2020, the government is implementing measures to diversify the manufacturing base and identify new sources of growth and jobs" (ADB 2017).

5.1 Institutionalization of SME and SME financing tools in Bangladesh

SME development initiatives need to go long way in Bangladesh for incubating the entrepreneurs to make SMEs as a true engine for economic development. The contribution of SMEs in the national GDP is still around one quarter. Small and medium enterprises contribute about to 40% of manufacturing output of the country and 25% to national GDP (ADB, 2014). About 70-80% of non –agricultural work forces are engaged in 7.2 million firms in 2013 (ADB, 2014). An initiative to institutionalization of SME, 'SME Foundation', an apex body of Ministry of Industries and Commerce was the established in late 2010s basically to foster the SME sector. The prime activities of SME Foundation include training, business support and promotional activities like arranging SME fair in regional and national arena. However, government has not allocate any budgetary fund to SME Foundation to disburse the fund to innovative SMEs which (access to finance) is the main obstacle that the SMEs are facing in Bangladesh. However, SME Foundation has created a small fund with their own initiative to support the SME clusters which they disburse through some Banks and NBFIs. As a result SMEs have to go to the financial institutions (FIs) to meet the working capital demand in their business but due to high monitoring cost FIs charge high interest rate to SMEs.

High cost of finance of SMEs is a constraint for Bangladesh to gear up growth and access to credit is still limited to SMEs (ADB, 2016). Considering this issue, although Bangladesh Bank (the central bank) has instructed to the commercial banks to invest in SMEs for a specific percentage of their loan portfolio but due to collateral problem, banks are hesitating to finance SMEs. Because the NPL is SMEs is recently high in the Banking sector. However, there are eight different refinance schemes were implemented for banks and NBFIs by Bangladesh Bank and different Development Partners (DP) in recent years (Bangladesh Bank 2014-15). For example, the refinance scheme for amount of BDT 38,512 million which was subsidized to all commercial banks SME portfolios among 44,150 numbers of enterprises (ADB, 2014). There is neither specific act for SMEs or any FIs to support SMEs in Bangladesh.

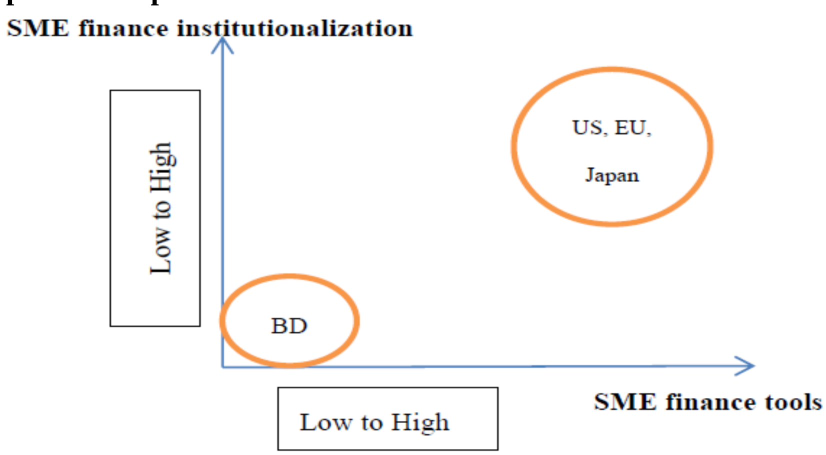
Therefore, in Bangladesh, SMEs institutionalization and finance are supported by two ways:

a. Through SME Foundation which provides advocacy, training to the SME entrepreneurs and financing to innovative SMEs cluster within limited scale.
b. Central bank instructs to all scheduled commercial banks and other financial institutions to provide loan to SMEs and also offer some incentives to the financial institutions while SME finance.

6. Summary discussion on Institutionalization of SME and SME finance tools

While discussion on economic history and SME finance model of Europe, Japan , US and Bangladesh, we mainly attempt to focus on two basic points. Firstly, the role of institutional arrangement to support the SMEs or to create a SME ecosystem and secondly, explore the tools that is used in developed countries to support the innovative SMEs. While analyzing the institutional supports, it is evident that, the US, EU and Japan has well established SME ecosystem (from SME act to Small Business Administration) and use credit guarantee scheme to Venture capital and crowd funding to support innovative SMEs. As a result the credit risk of investment in SMEs is diversified to various channels and the institutions ensure transparency and removed all red tape in SME development. In contrast, we can say that, Bangladeshi SMEs are still stay at seed stage in both parameter (institutionalization and source of funding) comparing with developed countries. The graph 6.1 show the comparative position of US, EU, Japan with Bangladesh while SMEs finance institutionalized stage and using the tools to support SME finance.

Graph 6.1 Comparison of SME institutionalization and SME finance tools



However, it is evident from the discussion on the economic history of developed nation that, European countries, the US and Japan has already industrialized in 1800s but Bangladesh has only started its journey as an independent state in 1972. Therefore, the policy and tools should not be equally justifiable in both parties. Another significance from this paper we can derived that, as Bangladesh has set a target to be an high income economy within 2041, the country have to prepare a road map for industrialization and set an effective institution to support small and medium enterprises. Furthermore, we see that the three regions (the US, EU and Japan) has developed their own tools while industrialization process and to support the innovative SMEs, no country has trying to mimic each other, rather they take pragmatic strategies that fit with their societies and culture. Therefore, we can say that Bangladesh should prioritize the goals and should take action bound strategy considering Bangladesh socio-economic perspective instead to rush to mimic the developed countries model.

7. Sustainable development goal 9 and challenges ahead to Bangladesh

There are seventeen (17) Sustainable development goals (SDGs) that were adopted by UN summit in September 2015 and on January 1, 2016 it comes into force. Among seventeen (17) SDGs, goal 9 refers that "*Build resilient infrastructure, promote inclusive industrialization and foster innovation"* (UN, 2017a, p.13). There are eight (8) targets and twelve (12) indicators were set for evaluation of the targets in goal 9. Among the eight targets the target 9.2 and 9.3 include:

Target 9.2:*"Promote inclusive and sustainable industrialization and, by 2030, significantly raise industry's share of employment and gross domestic product, in line with national circumstances, and double its share in least developed countries"* (UN, 2017a, p.13).

Target 9.3:*"Increase the access of small-scale industrial and other enterprises, in particular in developing countries, to financial services, including affordable credit, and their integration into value chains and markets"*(UN, 2017a, p.13).

Goal 9 mainly focused on transformation of economic sector in the least developing countries. For example, in SDG declaration, it is said that, "We will strengthen the productive capacities of least-developed countries in all sectors, including through structural transformation" (Source: UN SDG Declaration, Clause 27). However to achieve the structural transformation, there requires structural changes in GDP sectors. Islam and Iversen (2018) also mentioned such structural changes in GDP (contribution of manufacturing sector in GDP) has occurred in countries like China, India and Bangladesh in last one decades. They (2018) recommended that, LDCs should consider environmental issues while transformative change. However according to the SDG progress report 2017, the progress of goal 9 regarding target 9.2 and 9.3 are described as follows:
"Globally, manufacturing value added as a share of GDP increased from 15.3 per cent in 2005 to 16.2 per cent in 2016. In 2016, manufacturing value added per capita amounted to $4,621 in Europe and Northern America, compared to about $100 in the least developed countries" (UN,2017b, p. 11).

This statistics confirm the true comparison of the contribution of manufacturing industry in GDP between developed economics and LDCs. Bangladesh is a lower middle income economics (as per World bank classification, gross national income (GNI) per capita $1006-$3955 considered as lower middle income and $3956-$12,235 as upper middle income) having GNI per capita for 1976, 1986, 2006 and 2016 are $200, $240, $360, $560, $1,360 respectively (Source: World Bank Database). This trend indicates that, the capacity of growth rate of Bangladesh for last four decades and also helps to predict the future growth rate. However, based upon GNI, Human Asset Index (HAI) and Economic Vulnerability Index (EVI), the United Nations apex body "Committee for Development Policy" (CPD) has recently officially announced that Bangladesh will eligible to graduate from LDC category and enter into lower middle income group by 2024. This announcement absolutely brings a positive footprint for Bangladesh to achieve the Sustainable Development Goals by 2030. However it is mentionable here that Bangladesh enters into the World Bank LDC group in 1975 and only five countries are so far been graduated from LDC in past forty years. Further the question arises what will be the challenges ahead to Bangladesh when once the country graduates from LDC. Alonso et al., (2014) mentioned that the middle income countries (MICs) also faced three types of trap while graduation from LDC. They refers that productivity and productive change, green technology and energy transformation and macroeconomic stability and international financial integration are the major trap that most of the MICs fall in. Freire (2017) finds that only market incentives are not enough to foster industrialization in developing economics rather government should play an active role in this stage. Therefore, it is very sure that Bangladesh might fall in middle income countries trap in the next decade. For example, only ten percent (10%) of middle income countries in 1960 elevated in to high income country by 2010 (Agenor et al., 2012). Therefore, the challenges ahead for Bangladesh is to keep the steady growth, equitable distribution of income, safe structural shifting of economy and built a model to develop a industrialization friendly SME eco system which act as a backward linkage of heavy industry.

While discussing in the previous parts of this paper, it is evident that in European countries specially Britain, United States and East Asian economics like Japan, has their own SME development model through which they enhanced their economic growth as well as bring equitable distribution of income in the society. Unfortunately, Bangladesh has no alternative economic and political lever as developed economy and some East Asian countries have, except adopting US led open economy and western-style democracy.

Therefore there is scope for future research to find how Bangladesh has to develop its own SME institutionalizing process and access to SME finance model considering its indigenous strength. It is not only help to achieve the SDG goal 9 but also can be supportive to overcome middle income trap (MIT) upon final graduation from LDC in 2027 (it takes three more years after 2024 to official graduation). Another challenge towards goal 9 implementation in Bangladesh is income inequality. Barro (2000) and Kharas and Kholi (2001) discussed theoretically on how inequitable distribution of income can lead an economies into MIT. In addition, Reis (2014) finds that inflation, overheated labor market and backlog in education are the prime reason for decade long sluggish economic growth in Brazil. Hence, Bangladesh government and policy makers should also ware of such issues while implementation of SDG 9.

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