

## ACCESS TO FINANCE FOR SUSTAINABLE CONSUMPTION AND PRODUCTION PRACTICES BY SMALL AND MEDIUM-SIZED ENTERPRISES IN BANGLADESH



This briefing summarises main findings of a desk analysis, literature review and interviews conducted on the topic of access to finance for **Sustainable Consumption and Production** (SCP) practices by SMEs in Bangladesh. The analysis was conducted as part of work in support of the EU SWITCH-Asia programme, by the SWITCH-Asia SCP Facility.

### SCP IN THE SME SECTOR IN BANGLADESH

Bangladesh is one of the fast-growing economies in South Asia, seeking to become a middle-income country by 2030. It has made great strides in terms of social, economic, and technological development. Its gross domestic product (GDP) growth rates have been continuously high in recent years and it has more than tripled its per capita income between 2000 and 2017.

Yet, the country is struggling with environmental challenges. Rapid industrialization in the past decades, lack of environmental protection and high population density have led to high levels of pollution and ecological degradation. Air, water and land pollution are damaging the natural ecosystems, thereby also diminishing biodiversity and straining resources. This adds to widening social inequality. Bangladesh is known as a manufacturing hub for the region and beyond, exporting ready-made garments mainly to Europe and the US. Work conditions and environmental impact of these factories and workshops are often problematic. Meanwhile, a growing middle class has taken up Westernised consumption styles, and multinational companies and local subsidiaries and companies are distributing products that are not fit for the underdeveloped waste management system in Bangladesh. Hence, there is great need for increasing sustainability of consumption and production. International buyers are also placing increasing importance on workers' safety and sustainability.

SMEs comprise a significant portion of the economy, especially in the manufacturing and construction sector. They account for 45% of value addition in the manufacturing sector, 80% of industrial employment, and 75-80% of export earnings. Cleantech and related finance has been on the rise in Bangladesh in recent years. A study on Clean Technology Adoption for Textile SMEs in Bangladesh, for example, identifies the trend in awareness and adoption of clean technology in the textile sector, including energy efficiency measures.

Access to investment and working capital is crucial to support SMEs in professionalizing and expanding their SCP practices and services. The following presents an overview of financing opportunities for SMEs and their SCP-related activities and summarizes recommendations to Development Finance Institutions for increasing (access to) relevant funding.

## FINANCING OPTIONS

SMEs in Bangladesh can tap into two types of financing for their investments into SCP practices:

- **General:** Financing that does not have a specific (environmental or social) purpose beyond promoting SMEs. Bangladesh has successfully installed a micro-credit system based on group guarantees. Main financial institutions are commercial banks, where Bangladesh's banking sector has been growing considerably, though facing above-average non-performing loans even before the Covid-19 pandemic. There are 57 banks active in Bangladesh, 40 private domestic commercial banks, nine foreign commercial banks and six state-owned commercial banks. In addition, two specialised banks cater to specific target groups. The total banking sector lending to SMEs and micro enterprises almost tripled from 2010 to 2016 and has continued to grow until 2019. Other important actors include non-banking financial institutions and impact investors, though the former have come under scrutiny, as an important institution, the People's Leasing and Financial Services Limited (PLFSL) was liquidated in 2019. The SME and Special Programme Division of Bangladesh's Central Bank (Bangladesh Bank) has supported SME lending by way of several specialised programmes and policy initiatives, starting in 2009. The financing gap for SME is still estimated at BDT 237 billion (USD 2.8 billion). General finance can potentially be used for SCP but is not adapted to the specific requirements of SCP projects.
- **SCP-specific:** Financing that is specifically earmarked for SCP (or related purposes) and that considers particular characteristics and financing needs of the implementing companies and their SCP projects. Bangladesh Bank has been promoting green financing in several ways. Ultimately, however, all of these are aimed at SME growth and sector expansion. In particularly polluting sectors, like plastics, textiles and leather, this goal will not easily be aligned with the green finance objective of limiting and minimizing environmental risk. SME policies and financial schemes as well as the environmental legislative framework therefore must be continuously monitored and adjusted to be able to shape the "greening" and growth of these industries simultaneously. To address this, several measures are targeted at SMEs, including refinancing support, policies that promote sustainable finance, and cooperation with donor-funded projects.

### Action taken by Bangladesh Bank (BB) to promote green financing

Sectors identified as important to a "green" transformation of Bangladesh's economy are targeted by specifically "green" activities of BB. They include renewable energy, plastic industry, textile, jute and leather sector, food processing and agri-products.

#### Re-finance support (Bangladesh Bank 2020a):

- In 2009, BB established a BDT 2 billion (USD 23.6 million) **re-financing scheme** for Environment Friendly Products/Initiatives (e.g. solar energy, biogas facilities and effluent treatment plants). Initially limited to six green goods/initiatives, the number of eligible investments was eventually raised to 55 and the overall funding was increased to BDT 4 billion (USD 47.2 million) (Bangladesh Bank 2020a). The total amount spent under the scheme has amounted to BDT 2.93 billion (USD 34.6 million) between 2014 and 2019. The green industry, biogas, effluent treatment plants and brick kiln technology are among the most affected sectors. An analogous re-financing scheme is also available for **Islamic Banks and Financial Institutions**, funded by excess liquidity of shariah-based financial institutions.
- **The Green Transformation Fund** provides re-financing for manufacturer-exporters against import of capital machinery and accessories for implementing specified green/environment-friendly initiatives. The Fund disposes of over USD 400 million. Of this, USD 85.79 million had been disbursed by 09/2020. While previously focused on garment, jute and leather, it now encompasses all sectors. It facilitates financing for the import of machinery and technology including resource efficiency and recycling, renewable energy, energy and water efficiency, air ventilation and circulation, and workers' health and safety. Also relevant for SMEs, the GTF is accessible for commercial banks for on-lending and re-financing to eligible borrowers.

## Policies to promote sustainable finance (Bangladesh Bank 2020a):

- In 2011, it issued **Environmental Risk Management (ERM) Guidelines** for Banks and Financial Institutions (FIs) (updated in 2017 to also include social risks).
- In 2011, it issued **Policy Guidelines for Green Banking** (updated in 2013). These require banks and FIs to take measures to accelerate sustainable business practices and lending, e.g. through development of green banking policies, reporting on their green banking activities, determining green targets, introducing innovative green financial products, giving preference to eco-friendly business activities and introducing programs to educate clients. Compliant banks receive preferential treatments by the BB (Bangladesh Bank 2011).
- Since 2015, banks and FIs have to allocate at least 10% of their Corporate Social Responsibility budget to internal **Climate Risk Funds**. The money can be used to provide grants or concessional loans to green projects.
- Since 2016, banks and FIs have to **allocate at least 5%** of the total loans to green finance; this was updated in 2021 to at 15% dedicated to sustainable financing.
- Since 2016, all banks and FIs must ensure the establishment and activeness of **Effluent Treatment Plant (ETP)** during financing to all possible clients.
- In 2020, a Sustainable Finance Policy for Banks and Financial Institutions was published (Bangladesh Bank 2020) which includes a green finance taxonomy as well as analysis regarding a green bond standard.
- Also in 2020, guidelines on BB refinance scheme for 55 green products, projects, and initiatives within 9 green categories were published.

BB is also involved in **donor-aided industry development projects**:

- Some of the most active **international donors** are the World Bank, the ADB, the Global Environment Facility (GEF) and the German Development Bank (KfW).
- The **Green Climate Fund (GCF)** has funded projects worth more than USD 80m in the country.
- Especially **industrial energy and resource efficiency** in the garment sector is a prominent theme for bi-/multilateral finance. KfW, for example, issued a low-interest loan of €156m to the Bangladesh government in 2019 to strengthen the overall energy efficiency in the country.

Due to BB's ambitious work on building framework conditions, green finance is on the rise in Bangladesh. Existing financing options can be grouped into the following categories:

**Banks:** The financial sector of Bangladesh is mainly a bank-based system. Between 2014 and 2019, banks provided BDT 289 billion (USD 3.4 billion) in direct green finance. The majority of this funding was directed to waste management, green brick manufacturing, green establishment as well as recycling and recyclable products. Table 1 provides a snapshot of green finance in the year 2020 (Bangladesh Bank 2020b):

**Table 1: Volume of green finance products of banks and NBFIs in 2020 (in million BDT)**

Types of Bank/FI	Category of Green Finance								Total
	Renewable Energy	Energy Efficiency	Alternative Energy	Waste Management	Recycling & Recyclable Product	Green Brick Manufacturing	Green Establishment	Misc.	
SOCBs (06)	7.48	0.00	0.00	660.05	290.85	363.25	579.85	7.43	1,908.91
DFIs (02)	8.33	0.00	0.00	0.01	0.00	0.00	0.00	1.49	9.83
PCBs (40)	1,979.41	6,398.37	10.08	8,878.87	8,298.55	8,402.90	3,2737.93	2,962.65	69,668.75
FCBs (09)	608.60	327.70	0.00	283.80	4.60	0.00	33,072.40	35.59	34,332.69
<b>Bank's Total</b>	<b>2,603.83</b>	<b>6,726.07</b>	<b>10.08</b>	<b>9,822.72</b>	<b>8,594.00</b>	<b>8,766.15</b>	<b>66,390.18</b>	<b>3,007.16</b>	<b>1,05,920.18</b>
FIs (33)	942.36	2,819.03	6.00	240.00	272.69	432.13	350.00	233.00	5,295.20
<b>Grand Total</b>	<b>3,546.19</b>	<b>9,545.09</b>	<b>16.08</b>	<b>10,062.72</b>	<b>8,866.69</b>	<b>9,198.28</b>	<b>66,740.18</b>	<b>3,240.16</b>	<b>1,11,215.39</b>

Source: SFD, BB.

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In 2020, **Private commercial banks** (PCBs) accounted for the majority of total green finance, followed by **foreign owned commercial banks** (FCBs) who contributed around half the amount of their domestic peers. Meanwhile, **state-owned owned commercial banks** (SOCBs) and **development finance institutions** (DFIs) contributed only minor shares (Bangladesh Bank 2020b). Banks that provide specific green financial loan products include Prime Bank Ltd., BASIC Bank, Shahjalal Islami Bank, Midland Bank Limited, IFIC BANK, Eastern Bank Limited, EXIM Bank and Mutual Trust Bank. Other banks provide SME lending with relevance for SCP (modernization, technology upgrading). However, despite green finance policies and the 5% credit quota, green banking made up only 1.6% of the total banking business in Bangladesh in 2020. Some banks are still in the first stage of implementing Bangladesh Bank's guidelines.

**Non-bank financial institutions (NBFIs):** In addition to banks, NBFIs play a key role in financing and refinancing green activities. Bangladesh's 34 NBFIs accounted for nearly 12% of the total green finance in Bangladesh during the period 2014–2019 (BDT 38 billion / USD 448 million). The state-owned Infrastructure Development Company Limited (IDCOL) is among the most prominent NBFIs. It has several open lines of credit for sustainable energy projects like solar rooftop and microgrids and provides concessional refinancing and support services to microfinance institutions. IDLC Finance Limited is currently the only signatory to the UN Principles of Responsible Banking. More than 600 Micro-finance institutions (MFIs) exist in Bangladesh. While predominantly focused on the agricultural sector and Micro businesses, some of these also offer financing for small to medium-sized enterprises. IDCOL has partnered with these institutions for example by promoting solar energy systems, biogas, and solar irrigation systems.

**Investors:** Bangladesh has created limited scope for green equity finance. In 2018, fifteen venture capital firms were working on green projects. Underdeveloped bond markets and an immature capital market slow the uptake of green bond facilities in the country. With the definition of a green bond standard, numerous green bond applicants are currently pending. The first green bond was approved in 2021. Launched by SAJIDA Foundation, the bond provides micro loans to small businesses and social initiatives including regarding agriculture and installation of solar power.

**Bangladesh government** itself provides green finance through two funds that were founded to implement the Bangladesh Climate Change Strategy and Action Plan (BCCSAP). These funds have proven to be the most important public sources of cleantech funding. While SMEs were not directly eligible, they did profit from the project finance made available through these funds:

- **Bangladesh Climate Change Trust Fund (BCCTF):** Funded entirely from the government's budget, the BCCTF mostly finances climate change adaptation projects. Until 2020, the BCCTF approved 788 projects and allocated BDT 38 billion (USD 448 million). Almost 61% of the financing went to infrastructure-related projects, 18.3% were allocated to mitigation and low carbon development-related activities and 10.8% went to food security, social protection and health. Most of the projects are implemented through different Ministries and governmental authorities, whereas 61 projects are implemented by NGOs under supervision of the state-owned Palli Karma Sahayak Foundation (PKSF).
- **Bangladesh Climate Change Resilience Fund (BCCRF):** The BCCRF was a donor-aided fund that worked from 2010 until mid-2017. It disbursed USD 71.13 million via a range of thematic programmes as well as individual investment projects.

In addition, the previously mentioned SCP-relevant **Green Transformation Fund (GTF)** supports environmental initiatives in the manufacturing sector through refinancing.

**International finance:** As described above, international donors provide funding for industrial development. One scheme that can be directly accessed by SMEs is the Good Fashion Fund (GFF). It provides US-dollar denominated debt financing for SME textile and apparel manufacturers in Bangladesh, India and Vietnam. Investments must reduce the consumption of either water, energy or materials by at least 50%. The GFF also provides access to industry networks, impact expertise and sustainable technologies.

**Microfinance:** Microfinance in Bangladesh is provided by a variety of institutions, including NGOs, state-owned and private commercial banks, Grameen Bank and through some specialised programs of Bangladesh Ministries. In 2018, the Microcredit Regulatory Authority (MRA) approved licenses of 805 Microfinance Institutions (MFIs) that had a total sum of outstanding loans of around BDT 673.9 billion (USD 7.953 billion);



of this, the two leading MFIs (BRAC and ASA) contribute around 50% of outstanding loans. Microenterprise loans, which are considered to be credits of more than BDT 50,000 (USD 590), are more than 88% of the total outstanding loan sum as of June 2018, while being provided to 84% of all borrowers from only 8% of total MFIs.

Despite the existence of ambitious policies and growing action by banks and FIs, general and SCP-specific financing options for Bangladeshi SMEs are still limited. The following challenges affect the availability of green finance (for SMEs):

- **Access to finance:** SMEs often face considerable barriers for accessing finance to enhance their sustainability. Many of them do not comply with financial institutions' borrowing requirements (e.g., proof of creditworthiness, environmental clearance, due diligence and issue of governance) or cannot agree to their financing terms (incl. high interest rates and inflexible repayment schedules). Such requirements are an answer to the high share of non-performing loans in the past. Also, bureaucracy and lack of information hinders SME access to finance.
- **Investment demand:** At the same time, SMEs' demand for green technologies and respective financing is stifled by their lack of technical know-how and by taxes / tariffs on imported technologies. Investment demand does not usually surpass 5 crore BDT. Moreover, SMEs seem to lack of awareness of available schemes for green finance. FIs are thus unable to find a sufficient number of adequate green project proposals.
- **Financial institutions' capacities:** Finally, financial institutions lack capacity to manage green projects and appetite for green projects that are perceived as risky. This has resulted in slow growth of green finance. Non-performing loans, poor governance, lengthy legal procedures and financial scams weaken the banking sector's ability to provide funding in general.

## RECOMMENDATIONS TO DEVELOPMENT FINANCE INSTITUTIONS

Both general and SPC-specific finance for SMEs need to be further promoted in Bangladesh. Moreover, SME's motivation to invest in sustainable consumption and production also has to be raised, in line with growing environmental problems and international demand for greater sustainability. Development finance institutions (DFIs) can play an important role in shaping conducive framework conditions. Existing literature (see "Sources") highlights the following recommendations:

### Understanding SME business cases that promote SCP and their financing needs

- Numerous examples of commercially successful SCP-relevant business cases exist, including case studies by the SWITCH-Asia programme. Given the increasing importance of SCP, it would be advisable for DFIs to analyse their setups and success factors, in order to be well-positioned to act as financiers; this is similar to the last decade of investments in renewable energy and energy efficiency, where DFI capacity has grown considerably.
- SMEs investing into SCP practices often have unique needs. DFIs should dedicate efforts into understanding these and also build up their knowledge on financially directly or indirectly relevant impacts (like supply chain requirements, cost structure, reputational risk, etc) as well as the larger policy context (Paris Agreement, SDG 12, Green Deal, etc). to be able to develop targeted and impactful programmes in line with the EU's policy priorities.

### Improving access to finance for SMEs

- DFIs can support domestic financial institutions in the standardization of the credit granting process to decrease administrative costs related to small ticket sizes. Focus could be on promoting digital credit application tools and clear sustainability benchmarks. Financial support by DFIs could also include, targeted blending schemes as well as guarantees.

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- In order to minimize the high transaction costs associated with making green loans available to small-scale businesses, a cooperative scheme could be put in place that allows small-scale green start-ups to make collective use of green funding from banks and FIs. DFIs could support the establishment of such a scheme, e.g. in cooperation with BB and a number of PCBs.
  - DFIs could support BB in creating platforms for exchange between SMEs and banks/FIs to increase the reciprocal understanding of SMEs' operating reality and FIs' evaluation criteria for green loans. In addition, more awareness could be raised regarding green start-ups, with good examples of those SMEs who have experienced significant growth utilizing the schemes.

### **Promoting demand for green finance and development of green project proposals**

- DFIs could support the government and/or partnering banks/FIs in raising awareness of green finance and its benefits for growth, innovation and competitiveness.

### **Improving implementation of green finance policies by banks and NBFIs**

- DFIs could support partnering banks/FIs in broadening their knowledge about SCP (incl. potential for cost savings, international supply chain and disclosure requirements) and in training staff so as to strengthen their motivation to provide relevant funding.
- DFIs could connect banks and FIs with finance intermediaries that have technical and/or local expertise with regard to cleantech and RECP, in order to optimise the design and marketing of cleantech financial products.
- DFIs could conduct further research on the challenges for implementing green finance policies in order to identify helpful support measures and best practices for banks that lag behind. Such best practices could also be gathered through exchange between FIs from Bangladesh and other emerging economies. Examples from countries with similar context can be considered.
- Finally, Bangladesh Bank must track the compliance of commercial and non-commercial banks with green banking guidelines. DFIs could support this by assessing compliance of the local banks and FIs with which they work.

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