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STAFF APPRAISAL REPORT

BANGLADESH

THIRD SMALL SCALE INDUSTRY PROJECT

August 13, 1980

Industrial Development and Finance Division
South Asia Projects Department

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CURRENCY EQUIVALENTS

The Bangladesh Taka is officially valued at 36.30 (selling) and 36.25 (buying) to the Pound Sterling. The Pound now floats relative to the US Dollar and, consequently, the Taka/US Dollar rate is subject to change, averaging about Tk 15.5/US\$ over the past two years. The rate below has been used throughout the report.

US\$1	=	Tk 15.5
Tk 1	=	US\$0.0645
Tk 1 million	=	US\$64,500

PRINCIPAL ABBREVIATIONS USED

BADC	-	Bangladesh Agricultural Development Corporation
BCIC	-	Bangladesh Cottage Industries Corporation
BHMC	-	Bangladesh Handicrafts Marketing Corporation
BIBM	-	Bangladesh Institute of Bank Management
BIDS	-	Bangladesh Institute of Development Studies
BJMC	-	Bangladesh Jute Mills Corporation
BSB	-	Bangladesh Shilpa Bank
BSCIC	-	Bangladesh Small and Cottage Industries Corporation
BSFC	-	Bangladesh Sugar and Food Corporation
BSIC	-	Bangladesh Small Industries Corporation
BSRS	-	Bangladesh Shilpa Rin Sangstha Bank
BTMC	-	Bangladesh Textile Mills Corporation
EPB	-	Export Promotion Bureau
GOB	-	Government of Bangladesh
ILT	-	Institute of Leather Technology
IRDP	-	Integrated Rural Development Program
KSS	-	Krishi Samabaya Samity (Village Level Cooperative Society)
NSIC	-	National Small Industry Corporation Ltd. of India
SCI	-	Small and Cottage Industry
SID	-	Small Industry Department
SSI	-	Small Scale Industry, excluding Cottage
SSI II	-	Second Small Scale Industry Project
SSI III	-	Third Small Scale Industry Project
TCCA	-	Thana Central Cooperative Authority
XPL	-	Export Performance License

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This report is based upon the findings of an appraisal mission which visited Bangladesh in February-March 1980. The mission comprised N. Barry, S. Kandel, J. Pernia, and C. Punsalan.

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BANGLADESH

APPRAISAL OF A THIRD SMALL SCALE INDUSTRY PROJECT

I. Background

1.01. The Government of Bangladesh (GOB) is giving high priority to small and cottage industry (SCI) development in meeting its growth and employment objectives during the Second Five Year Plan period (FY81-85). IDA has helped finance two small industry projects in Bangladesh. GOB has requested a third, significantly larger IDA credit to assist in providing needed services for this sector. This report recommends an IDA credit of SDR 26.7 million (US\$35 million) with SDR 22.9 million (US\$30 million) for subloans for viable SCIs and SDR 3.8 million (US\$5 million) in technical and marketing services for promising segments of the SCI sector.

1.02. Past SSI Projects. The first small-scale industry project (Credit 353-BD), approved in December 1972, provided US\$3 million to finance foreign exchange portions of loans to small industries and a consultant to assist the Bangladesh Small Industry Corporation (BSIC) ^{1/} in subproject appraisal. Under the project, BSIC was responsible for screening, appraising and supervising subprojects. Participating commercial banks assessed creditworthiness of clients once subprojects were approved by BSIC, disbursed funds, and collected repayments; the banks had veto power on BSIC's decision to finance a subproject. Repayment risks were split 50:50 between BSIC and the banks. As indicated in the Project Completion Report of May 1979 (PPAR No. 2982), the objectives and impact of Credit 353-BD were modest. Thirty-eight subprojects were financed, mainly in synthetic textiles and oil milling, in the three major urban centers. Repayment performance, initially poor, has improved as the banks have increased attention to follow-up and collections in response to supervision efforts by IDA. Major problems with Credit 353-BD stemmed from the split of responsibilities between BSCIC and the commercial banks and weaknesses in BSCIC's appraisal and follow-up performance. As of February 28, 1980, arrears represented about 35% of amounts due vs. 61% as of June 30, 1978. ^{2/} Further efforts are needed to improve collections.

1.03 Lessons learned from Credit 353-BD were incorporated in the design and institutional arrangements for the second small-scale industry project (SSI II) (Credit 825-BD). The US\$7 million credit has been effective since September 1978. Local and foreign exchange credit for SCIs has been provided through the two major commercial banks, Janata and Sonali, with an 18 month transitional period of joint appraisal by the lending bank and BSCIC, followed by autonomous appraisal by the banks. SSI II has provided consultancy to help BSCIC establish systematic promotion and extension services. Under the cottage industry component, the Bangladesh Handicraft Marketing Corporation (BHMC) has provided marketing and technical services to groups of jute, cane, and bamboo handicraft producers.

^{1/} The Bangladesh Small Industry Corporation (BSIC) was merged with the Bangladesh Cottage Industry Corporation (BCIC) in 1975. BSCIC is a semi-autonomous government corporation, under the Ministry of Industries, responsible for development of small-scale and cottage industries.

^{2/} Some repayments are being made on most subloans financed under Credit 353-BD.

1.04 Commitments under the subloan component proceeded well ahead of schedule. As of June 30, 1980, the US\$6.2 million subloan component was committed by the banks. IDA approvals total about US\$4.7 million. IDA disbursements and L/C openings represent about 25% of the subloan component. Janata and Sonali Banks have established strong Small Industry Departments (SIDs) at headquarters and have trained over 80 small industry specialists in the branches. The transitional phase of joint appraisal proved cumbersome particularly since BSCIC's management initially was reluctant to relinquish control over SCI subproject appraisal. However, the banks performed well with BSCIC's involvement in appraisal having become marginal. In November 1979, GOB and IDA reviewed SCI lending performance of Janata and Sonali; it was determined that they had demonstrated satisfactory appraisal skills, and that participating banks should have autonomous SCI appraisal and supervision responsibility under the proposed Third Small-Scale Industry Project (SSI III). As of June 30, 1980, 146 subprojects had been approved by the banks. Comparisons of subproject appraisal reports indicate that, in accordance with the eligibility criteria established, subprojects under Credit 825-BD have been more varied and geographically dispersed, more labor-intensive, and more dependent upon local inputs than those financed under Credit 353-BD. Annex 1 compares employment impact, use of local inputs, and regional dispersal of the two projects. Developments under Credit 825-BD provide the institutional base for sizeable involvement by IDA in SCI lending.

1.05 The technical service component has been useful in helping BSCIC develop systematic tools for promotion and extension work. Some area and subsector potential studies have been completed; project profiles have been prepared; and diagnostic, monitoring and evaluation systems have been installed. The handicraft marketing component of SSI II has had considerable impact; BHMC has organized about 1,500 jute, cane and bamboo artisans into associations; extension workers have helped improve production methods and quality; and sales trips have resulted in doubling of BHMC's exports of products of these artisan associations.

1.06 SSI III. SSI III would build on and extend institutional capabilities developed under the first and second projects. The three largest commercial banks and the Bangladesh Shilpa Bank (BSB) would be responsible for subproject selection, appraisal, supervision and collections. An SCI refinance facility is being established in Bangladesh Bank to enable rapid subproject review and refinance of SCI sub-loans made by the participating banks. Three major SCI segments would receive attention under the technical and marketing components: (a) organized small industries, mainly serving local markets; (b) export enterprises in handicraft and light industrial product lines; and (c) agro-related small enterprises. BSCIC would be assisted in strengthening and decentralizing extension services for organized small industries, with project elements including a subcontracting exchange, sub-sector programs, and pilot projects with private participation. The Institute of Leather Technology would provide common facilities and technical services to small- and medium-scale tanneries. The Export Promotion Bureau (EPB) would manage an export and product development program for handicraft and light industrial products, which would finance consultancy and trips for exporters. The cooperative network would be used to promote agro-related rural enterprises such as beekeeping, small livestock and fishponds among a target group of landless and marginal farm families.

II. SECTORAL BACKGROUND

A. Economic Setting

2.01 During the 1970s, foodgrain production in Bangladesh did not keep pace with increases in population. Economic growth was uneven, averaging slightly over 5% p.a. since 1975/76, when real GDP recovered to the pre-independence level. Industrial promotion was concentrated on larger, relatively capital intensive industries; employment levels stagnated and real wages declined. Economic growth decreased to some 3% in 1979/80, mainly due to reduced grain output caused by poor weather. Due to food shortages and rising petroleum prices, inflation accelerated, inequalities in income distribution were aggravated, and the balance of payments position remained precarious.

2.02 In the short term, GDP could again achieve a 5% growth rate if weather is reasonably good and if crucial inputs such as fertilizers, cement, petroleum and spare parts are available. The draft Second Five Year Plan sets ambitious goals including attainment of self-sufficiency in food and an average 8% annual growth rate in industry. Successful execution will require a major domestic savings effort, efficient use of scarce resources, and significantly improved implementation capability. Continuous efforts will be required in expanding the use of modern agricultural inputs, improving family planning, increasing efficiency in public corporations, and encouraging private sector investment. Unless employment opportunities outside agriculture increase, incomes of landless and marginal farm families are likely to continue deteriorating in real terms. Measures to accelerate appropriate industrial development therefore are crucial.

B. Industrial Structure and Performance

Role of Industry

2.03 In 1979/80, the industrial sector 1/ contributed about 11% to GDP. Large and medium industries, mainly in the public sector, account for about 50% of industrial value added; private registered and unregistered SCIs contribute the other half, accounting for about 90% of value added in private industry. 2/ The public manufacturing sector consists of about 300 units under seven corporations; these include jute, the largest export industry, and such import-substituting industries as textiles, chemicals, pulp and paper, and

1/ Excluding the construction sector.

2/ The official industrial production index and national accounts data underestimate the contribution of unregistered industries; the ratio in value added by large vs. small registered industries is about 60:40.

engineering. The SCI sector is composed of about 30,000 registered firms ^{1/} (excluding handlooms) and roughly half a million cottage and rural enterprises. Large and medium firms employ about 350,000, while SCIs provide full or part time employment to roughly 4 to 5 million persons largely in rural areas.

2.04 Recently, GOB has introduced somewhat more liberal industrial policies and encouraged greater private sector participation. Industry groups reserved for the public sector were opened to private investment; limits on private investment were increased; investment incentives and availability of term credit for private industry were improved. However, major efforts still are required to improve industrial efficiency, capacity utilization and growth. Capacity utilization in public corporations remains low, due in part to difficulties in importing inputs and spares, which could be alleviated by encouraging subcontracting with local firms (paras 3.04, 4.36). The investment environment would be improved by simplifying and liberalizing investment approval, import license, and export procedures. ^{2/}

2.05 In the two years following 1976/77, increased public and private investment aided by liberalized imports pushed real growth of manufacturing output to over 7% p.a. In 1979/80, due to the surging petroleum and food import bill, GOB adopted a more restrictive import policy; growth of large and medium scale manufacturing declined to 3.5% p.a. while SCIs grew by some 6% p.a. During 1978/79-1979/80, industrial export earnings increased by about 50%, mainly due to favorable international prices for jute and jute goods. Non-traditional exports, mainly of frozen seafood, leather, newsprint and handicrafts increased their share of total exports from 10% in 1976/77 to 14% in 1979/80.

2.06 Small-scale industry, with its strong links to agriculture, has good growth prospects if even a portion of the ambitious development plan is implemented. To realize these prospects, however, SCIs need greater access to credit, technical, and marketing services.

C. Characteristics and Role of Small and Cottage Industries

2.07 Definition. GOB recently changed the definition of small-scale industries to include firms with up to Tk 2.5 million in plant and equipment excluding land and buildings. Using this definition, small firms account for about 45%

^{1/} Registered industries are those registered with the Department of Industries or BSCIC. Registration normally is sought by organized small industries which require import licenses.

^{2/} Under the IDA-financed import credit program, the system of export incentives is being streamlined (World Bank Report No. P-2664-BD, January 1980). Under the IDA Credit to Bangladesh Shilpa Bank (BSB), GOB agreed to conduct a study on investment approval procedures for industry and to implement the recommendations; completion of the study is expected in the last quarter of 1980.

of registered private firms, 100% of unregistered firms, 80% of industrial employment, and 50% of investment in industry. Cottage industries are defined as manufacturing or industrial service activities performed by fewer than 10 workers, normally family members; most operate without electricity. Rural enterprises are similarly defined, although the category includes agro-related activities such as beekeeping, small livestock and pond fisheries.

2.08 Geographical and Subsectoral Distribution. About 50% of registered SCIs are located in Dacca, with secondary concentrations in Chittagong and Khulna (Annex 2, Table 1). Unregistered firms are more widely dispersed among small towns and villages with some clusters in thanas of Dacca, Comilla and Barisal districts; only about 5% of these units are in larger cities. The proportion of the rural labor force employed in rural enterprises varies considerably among thanas, ranging from as high as 55% to as low as 15%. Six subsectors--food processing, power- and handloom, wood, leather, paper and metal products--account for about 91% of employment, 90% of investment and 94% of value added of registered small industries (Annex 2, Table 2). The largest single group is agro-processing which accounts for 61% of investment, 55% of employment, and 53% of value added of registered small industries. Among unregistered SCIs, handloom production accounts for about half of the enterprises and 60% of employment, with secondary concentrations in food processing and cane, bamboo and wood products (Annex 2, Table 2).

2.09 Potential. Good local market potential exists for industries processing agricultural, fishing and livestock products. The anticipated public investment in agriculture is expected to generate additional demand for implements, spares, repair services, and construction materials. Considerable potential exists for firms to expand markets through subcontracting to larger public corporations for spares and components. In rural enterprises, potential exists in agro-related activities such as beekeeping, small livestock, and pond fisheries which use local raw materials, have strong local demand, and limited land, capital, and skill requirements (paras 3.15, 4.49-4.53). Product and market surveys sponsored by the Export Promotion Bureau indicate that significant scope exists for expanded exports of handicrafts, finished leather and leather products, cane and bamboo products, ready made garments, ceramics and spices. All of these products are or can be made efficiently by SCIs; most build on traditional skills, use local raw materials and require labor intensive processes. Improvements are needed in market information, product quality and design, organization of the decentralized production base, and contacts with buyers. The proposed project contains components to help overcome these constraints (paras 4.43-4.46).

2.10 Performance and Efficiency. Annex 2, Table 3 indicates that SCIs compare favorably with large firms on efficiency measures in most subsectors in which SCIs are active. In these major groups, SCIs have lower capital-labor ratios and higher value added per unit of labor and capital cost. In 1976/77, the rate of return on capital ^{1/} amounted to 60% for small industries and 40% for larger firms. Unregistered SCIs showed the highest rates of

^{1/} Calculated as net earnings over total investment (fixed assets including permanent working capital).

return in all subsectors in which they are active. These figures contain a significant margin of error due to accounting and statistical practices, but do indicate that SCIs compare favorably with large firms on financial and economic performance, since Bangladesh at present has no special protection for SCIs which would cause economic distortions.

D. Industrial Policy Framework

2.11 Incentives and Allocations. The draft Second Five Year Plan states that priority will be given to development of small and rural enterprises in meeting industrial growth, employment, and export objectives. GOB intends to improve services for SCIs rather than relying on differential incentives for this sector. Measures include: (a) improving refinance facilities for term credit to SCIs with attractive spreads for the participating banks; (b) encouraging decentralization of large firms by encouraging subcontracting links with small industries; and (c) introducing a system of preferential but not compulsory public sector procurement from SCIs. However, the draft of the Industrial Investment Schedule for 1980-82 as submitted by GOB at negotiations includes separate allocations for SCIs in a number of product lines. Reserving investments in the absence of in-depth analysis of economies of scale can lead to misallocation of scarce resources. GOB intends to use the investment allocations strictly as indicative guidelines rather than controls. This will be specified in the Policy Statement accompanying the final Investment Schedule. SSI III would help finance technical assistance for a study by the Planning Commission to determine the most promising areas for investment by SCIs, to enable less reliance on the Investment Schedule as a control mechanism (paras 4.55-4.57).

2.12 Export Incentives and Promotion. The present incentive framework for exporters includes income tax rebates, bonded warehouse facilities, export subsidies, duty reductions, and an export credit guarantee scheme. However, implementation problems exist and thorough review and streamlining of the system as envisaged under the Eighth Imports Credit (Credit 980-BD) are necessary. Four areas are of particular importance for SCIs and related exporters. First, most new and small exporters face difficulties in obtaining pre-export financing from the commercial banks. The Bangladesh Bank should intensify its efforts to improve coverage, capitalization, and application procedures for this scheme. Secondly, procedural complexities hamper implementation of the import duty drawback system; the progress on the review of the system has been relatively slow; GOB intends to accelerate the review to meet the completion date of July 31, 1981 required under the Eighth Import Credit. Thirdly, the present Export Performance License (XPL) System is complicated and arbitrary, and does not provide an effective incentive to save foreign exchange. The Steering Committee chaired by the Deputy Governor of Bangladesh Bank expects to report by end of August 1980 indicating a revised approach on XPL allocation including the use of a net foreign exchange criterion. Finally, while the promotional capabilities of the Export Promotion Bureau have improved, the EPB should increase its follow up on matters involving export procedures and should take the lead in organizing export promotion and product adaptation efforts in promising non-traditional product lines (paras 3.14, 4.43-4.46).

E. Financing Small Industries

2.13 From 1976/77 to 1978/79, domestic credit by the banking system grew by some 50%, mainly due to increased lending for jute, imports and agriculture. In the same period, savings grew sluggishly and commercial banks continued to rely heavily on refinance from Bangladesh Bank. However, as of July 1979, credit was tightened as a response to strong inflationary pressures. Lending to private industry increased from 23% of total industrial credit in 1977/78 to 26% in 1978/79. About 80% of term credit to industry is provided by two industrial development banks, the Bangladesh Shilpa Bank (BSB) and the Bangladesh Shilpa Rin Sangstha Bank (BSRS). Nine commercial banks, six of which are local and nationalized, provide mainly short term credit, although roll-overs are common and the banks have increased project-based lending to SCIs under special schemes. Limited capital market activities are undertaken by the government-owned Investment Corporation of Bangladesh.

2.14 Term loans to small enterprises account for roughly 25% of term financing for private industry. In the past, small amounts of term credit for SCIs were provided through BSCIC in consortium with the commercial banks. This consortium arrangement did not work well (para 1.02). Under SSI II, the banks now are responsible for appraisal, follow up and supervision. Janata and Sonali, the two largest commercial banks, have built sizeable SIDs at headquarters and have trained SCI specialists posted to key branches. Similar capabilities would be established in Agrani and possibly other commercial banks under SSI III. Nearly 50% of BSB's amount of lending is to small scale industry, mainly to firms with fixed assets of Tk 1.0-2.5 million.

2.15 Since statistics on private industrial investment and financing are limited, only rough projections of credit demand by SCIs are possible. Figures indicate that lending to SCIs has increased by about 30% per annum in nominal terms in the last two years. Demand for credit under SSI II has been strong with the US\$6.2 million subloan component fully committed by the commercial banks by June 30, 1980, well ahead of schedule; pipelines total about US\$4.5 million. An estimate of potential demand for credit by SCIs has been made in Annex 2, Table 4, based on conservative assumptions on growth of the sector, the incremental capital/ output ratio (ICOR), and permanent working capital requirements. Total investment requirements for SCIs 1/ for FY81 and FY82 are estimated to be about Tk 3.6 billion. This is a conservative assessment compared to projections for the Second Five Year Plan period which assume a 10% real annual growth rate of private investment. 2/

1/ About Tk 410 million is estimated to be from transport enterprises.

2/ GOB is committed to provide greater incentives to the private sector; planning authorities expect an immediate positive response by private entrepreneurs, especially small scale, in the initial period of the plan.

2.16 Financial institutions have covered only a minor portion of the financing needs of SCIs. 1/ With increasing willingness and capabilities by the banks to lend to this sector, it would be reasonable to anticipate that about one-third of total SCI financing requirements could be covered by the financial institutions. Taking into account anticipated levels of international and domestic inflation, demand for credit by SCIs could amount to roughly US\$45 million per year in current prices. In 1978/79, commercial banks and BSB lent about Tk 70 million (US\$4.5 million) in term credit to SCIs. Assuming that the banks will continue lending US\$5.1 million per annum in current prices to SCIs from their internal resources, the financing gap could amount to US\$40 million per year 2/ or US\$80 million over the two year commitment period. The IDA credit would provide US\$30 million to cover part of this potential financing gap; the remainder would need to be met through self-finance, informal financing sources, and short term roll-overs.

Interest Rates and Inflation

2.17 Annex 2, Table 5 provides the present interest rate structure in Bangladesh. Both deposit and lending rates have not changed since 1975/76. 3/ Commercial banks charge 11-12% for industrial loans; BSB and BSRS charge an average of 11.5%. Cottage industries, with limited access to institutional finance, borrow from money lenders whose rates are substantially higher. The rate of inflation, which averaged 12.5% during 1977/78 and 1978/79, escalated to some 18% by the middle of 1979/80, but has slowed since. The main factor contributing to the surge in inflation was the increase in food prices, due to shortages caused by drought. Escalating costs of imported goods, 4/ adjustments in many administered prices, and rapid liquidity expansion in 1978/79 in the context of slower economic growth exerted further pressures. If weather conditions are reasonably good in the period 1980/81-1981/82, inflation could return to more normal levels of 10-12%. At present, GOB is actively considering an upward adjustment in general interest rate levels, which is justified since lending rates are negative in real terms and have been in all but two years since independence. To ensure that interest rates are positive in real terms, under this Credit, SCI subloans would be made at a minimum interest rate of 13% per annum.

1/ An analysis of sources of funds for private industry in 1978/79 indicates that financial institutions provide about 67% of industrial private investment. However, the proportion of financing from other sources (e.g., self-finance, money lenders) normally is higher for small firms, since SCIs generally have much less access to institutional credit than do larger ones.

2/ Of this, about US\$8 million is credit demand by transport SSIs.

3/ Except for deposits in rural areas, for which rates were raised 0.75-1.5% in July 1978.

4/ In part due to exchange rate changes.

F. Technical Service Agencies

2.18 BSCIC is the government institution responsible for small industry development. With the shift of SCI lending responsibilities to the banks, BSCIC's major tasks now are to identify and promote new small industries and to provide technical services to existing ones. BSCIC has taken some steps to upgrade these services but considerable improvements still are required (paras 4.30-4.32). Other specialized agencies exist to assist SCIs in some priority subsectors. The Export Promotion Bureau now is taking a more active role in promoting exports by: helping establish associations; arranging consultancy in market research, strategy development and product adaptation; and organizing special fairs. Commercial exporters and private voluntary organizations play a significant role in organizing the decentralized handicraft base for exports. In rural enterprises, the Integrated Rural Development Program (IRDP) has promoted some successful agro-related activities, particularly among women's cooperatives.

III. STRATEGY FOR SMALL AND COTTAGE INDUSTRY DEVELOPMENT

3.01 Major potential exists for more rapid growth in four major SCI segments: (a) organized small industries catering to local markets; (b) exports of light industrial and handicraft products; (c) agro-related rural enterprises; and (d) cargo trucks. The Third Small Industry Project would help GOB meet the differing assistance needs of these SCI groups.

A. Improving Performance in Organized Small Industries

3.02 Many organized small industries have strong potential for growth and productivity improvement, if credit and certain technical and marketing services are provided as these firms move from small to medium scale. Unlike many cottage units, many owner-operators of organized small firms bring some management, marketing and technical knowhow to the enterprise. Most organized SSIs are located in or near urban areas and towns, enabling cost-effective credit and other services. Subsector-specific consultancy, general management advice, common service facilities, and subcontracting exchanges can assist organized small industry development, if these programs are properly structured.

3.03 Light Engineering and Metal Products. Light engineering and metal products SCIs consist of about 3,000 registered manufacturing SSIs, 19,000 service workshops, and 24,000 blacksmith cottage units. Ninety percent of registered units are located in towns which have access to electricity, water, and transport. Dominant product lines are machinery spares, vehicle parts, agricultural tools, hardware and agricultural implements. In the major lines, small units compare favorably with larger firms in labor intensity, value added/capital and gross profit/capital ratios (Annex 2, Table 2).

3.04 A recent survey sponsored by BSCIC indicates that capacity utilization for engineering SSIs ranges from 15% to 50%, mainly due to marketing

difficulties. The study also determined that growth and productivity improvements, with strong linkage effects, are possible particularly in: components and spares for industrial equipment, including vehicles and textile machinery; electrical fittings; hardware; and manufacture and repair of agricultural and irrigation equipment. These prospects are based on projected increases in agricultural activity and subcontracting potential from public sector corporations. The major corporations require about Tk 225 million annually in foreign exchange for imports of spares and components, mainly in the metal subsector. Local small engineering firms could manufacture at least 30% of this value, if some improvements in methods and equipment were made. Credit and technical services in the engineering subsector should improve utilization of existing capacity with investment in new capacity limited largely to regional repair workshops. A BSCIC subcontracting exchange would be sponsored under SSI III to facilitate sales by SSIs to public corporations (paras 4.36-4.37). BSCIC also would develop specialized technical services and subsector schemes for engineering firms, with particular attention to manufacture and repair of agricultural tools and equipment (para 4.34-4.35).

3.05 Leather and Leather Goods. Hides and skins constitute an important resource of Bangladesh and rank second to jute in export earnings, contributing Tk 1.5 billion in 1979. Presently, less than 20% of hides and skins are processed into low grade finished leather for domestic consumption; the remainder is exported after minimal "wet blue" processing. While the livestock population is not growing significantly, sizeable potential exists in adding value to "wet blue" by further processing into crust, finished leather, and leather products. Net export prices are roughly 40% higher for crust and 60% higher for finished leather relative to "wet blue". With high labor costs in developed countries, potential exists for crust and finished leather manufacture in countries such as Bangladesh. Once finishing capacity is increased, progress can be made in exports of footwear and leather goods. There are about 170 tanneries in the country, of which about 70 are small scale units. About 145 are in Hazaribagh, the traditional tanning center of Dacca; most of the remainder are in Chittagong. About 10 tanneries in Bangladesh have some finishing equipment; the rest work mainly with drums, paddles and pits, with little or no mechanical equipment. Most existing equipment is outmoded and in disrepair. There are about 62 organized footwear units with annual production capacity of 2.6 million pairs, and about 12,500 cottage footwear units which produce between 5 and 15 pairs of hand made shoes per day.

3.06 The major constraints in moving to higher value added products are lack of equipment and technical knowhow in crust and finishing processes. Most tanneries do not have qualified technicians who understand the chemical and mechanical processes involved in leather processing; poor quality control and processing methods reduce prices that hides and skins can fetch. The Institute of Leather Technology in Dacca, involved mainly in training artisans in tanning and manufacture of footwear and leather goods, provides some technical services to tanneries in Hazaribagh. SSI III would help increase export earnings from finished leather by establishing a program to provide common finishing facilities and technical services to private tanneries under the Institute of Leather Technology (paras 4.40-4.42).

B. Exports of Light Industrial and Handicraft Products

3.07 The importance of promoting manufactured exports to achieve growth, employment and foreign exchange objectives has been recognized by GOB in the Second Five Year Plan. At present, capacity utilization and production efficiency in many private enterprises are hampered by local market constraints due to stagnant purchasing power. Bangladesh could benefit from this greater export orientation, focusing on those subsectors in which low labor costs or local raw materials give Bangladesh potential comparative advantages.

3.08 Based on analyses of markets and supply capabilities for non-traditional exports from Bangladesh, the EPB has identified several handicraft and light industrial groups with immediate export growth potential, provided that improvements in quality, design, and production organization are made. These lines include: leather and leather products; cane, bamboo and knocked-down wooden furniture; specialized handloom textiles and garments; brassware; ceramics; jute and other handicrafts. Nearly all of these products are made by SCIs, are based on local raw materials, and generate employment with limited capital investment. To meet quality and style requirements, Bangladeshi leather goods would require: product improvement, with attention to selective mechanization; improved accessories; and standard sizes for US and European markets. Cooperation among tanneries, artisans and exporters is needed since the quality of end products depends upon ready availability of good finished leather and quick responses to fashion changes. Export prospects in garments are good, particularly in the US market, assuming continued freedom from import quotas. Studies indicate that the quality and price of readymade apparel by major manufacturers in Bangladesh meet medium quality export standards. While garment manufacturers now use imported inputs, there is scope for garments using local handloom cloth and labor intensive embroidery work, and for ancillaries providing accessories and packaging materials. The industry requires improved export links, bonded warehouses, export financing and expeditious issuance of import licenses. ^{1/} In wood and cane furniture and other household articles, Bangladesh has the advantage of low wages, a large pool of skilled artisans, and an abundance of the needed raw materials. Use of simpler knocked-down designs is advisable to respond to market demands, cut transport costs, and achieve uniformity.

3.09 Assistance Needs. In these subsectors, exporters already play an important role in organizing output of decentralized producers providing orders, designs, quality control and inputs. However, they have difficulty in meeting export requirements due to limited export contacts and problems in the supply base. Exports could be increased significantly by helping exporters make improvements in organization, methods, tools, and designs. To address these constraints, the proposed Credit includes an export and product development program managed by EPB which would assist exporters in improving decentralized manufacture and export of selected lines (paras 4.43-4.46). A portion of the subloan component is earmarked to provide term

^{1/} With these improvements, the EPB projects foreign exchange earnings of about Tk 100 million for the two-year period 1980/81-1981/82.

credit from the banks to exporters for financing processing and storage facilities as well as investment and working capital requirements of producers in the exporters' networks (para 4.16).

C. Developing Selected Rural Enterprises

3.10 Cottage Industries. A recent study performed by BIDS 1/ indicates that roughly 4-5 million mainly rural dwellers may be engaged in cottage manufacturing or repair operations. About 26% of these workers are landless, while 52% are marginal farmers who require activities outside agriculture to reach subsistence. 2/ As many as 80% depend on cottage industry as their primary source of income. Only about 30% have completed primary education. Clearly, cottage industries are of critical importance in alleviating acute unemployment and deteriorating incomes among the rural poor.

3.11 Constraints. However, characteristics of many cottage industries inhibit cost-effective institutional assistance to promote growth and productivity improvements. First, only a few cottage industry groups have significant geographical concentrations to facilitate credit or technical programs. Textiles, food and forestry products account for over 90% of cottage enterprises and employment. Nine product lines 3/ represent over 80% of units and workers. The only groups with sizeable rural concentrations are: handlooms; gur-making; cane and bamboo; and cordage, rope and handicrafts of jute. Relatively high concentrations in towns are found in repair services, paper products, metal items, bakeries, footwear manufacture, soaps, and dairy products. Traditional industry groups--blacksmithy, pottery, oils and fats, repair of leather goods, and jewelry--are scattered and account for less than 5% of total employment. Second, the tiny size of most cottage industries inhibits cost effective services. Over 60% of the enterprises have three or fewer workers and only about 5% have ten or more. Most firms consist largely of family proprietors and unpaid family workers; 4/ the traditional, family-based nature of most cottage industries inhibits receptivity to hiring outside laborers, introducing new production techniques, or responding to changes in market demand. The lack of entrepreneurial traits among most cottage industrialists makes questionable the benefits of expensive technical services. Also, most cottage industries cater to the demands of the rural poor, whose purchasing power has been deteriorating. Finally, many cottage industry groups (e.g., pottery, brass, blacksmithy) face growing difficulties competing with less costly and more durable modern substitutes.

1/ Bangladesh Institute of Development Studies, Rural Industries Study Project, May 1979.

2/ Bureau of Statistics, Land Occupancy Survey of Bangladesh, Dacca, 1977.

3/ Handlooms; cordage and rope; rice milling; gur; cane and bamboo mats; woodworking; tobacco; tailoring; and wood, cane and bamboo containers.

4/ Firms which average at least 8 workers are: brick making (50); jute baling (27); structural clay products (16); tobacco (12); lac and shellac (11); metal furniture and utensils (9); and preservation of fruit (8).

3.12 Selection Criteria. The most promising strategy for promoting cottage industry development would appear to be by focusing on those product groups: (a) with identified export or local market growth potential; (b) with significant geographical concentration to enable cost-effective services; and (c) for which productivity improvements are likely to result in significant increases in employment and earnings.

3.13 Local Market Prospects. Cottage industry product groups catering to local demand which appear to meet these criteria are: repair operations; metal products, except blacksmithy; bakeries and dairies; jute baling; lac and shellac; footwear manufacture; soap and cosmetics; bricks, tiles and other structural clay products; and fruit preservation. Most of these product groups are concentrated in towns rather than villages, average more than 10 workers per unit, have some degree of mechanization, and tend to be owned and managed by relatively young entrepreneurs. They therefore lend themselves to technical and managerial services similar to those of somewhat larger organized SSIs (para 3.02). Technical services could be provided by BSCIC and credit by the commercial banks.

3.14 Export Prospects. Several cottage industry groups have significant export prospects. Recent performance and market analyses indicate that the most promising lines are: cane, bamboo and wood items; specialized handloom products; ceramics; and jute goods. These lines are characterized by sizeable geographical concentrations in rural areas, household level organization, reliance on local raw materials (except handlooms) and local marketing difficulties. Major needs in these product groups are: adaptation in product design to meet specific export requirements; improvements in quality and productivity through quality control, selective mechanization and improved organization; and better relationships with importers who are willing to involve themselves intensively in development of the supply base for exports. Public institutions are in a relatively weak position to provide these services. SSI III will assist exporters in improving sales, the supply base and earnings of artisans (para 4.43-4.46).

3.15 Agro-related Rural Enterprises. In addition to cottage manufacturing and repair operations, rural enterprises include agro-related activities such as beekeeping, pond fisheries, goat rearing and poultry. Except for pond fisheries, these are predominantly household activities. Unlike many traditional cottage industries catering to local demand, these activities are profitable, can be replicated in many rural areas of Bangladesh since they are not skill-based, are not as dependent on special raw material endowments, and have sizable untapped local market potential. They can be developed on a concentrated basis reducing administrative costs of credit and technical service systems. Since most raw materials and markets are local, requirements for logistical support are reduced. These rural enterprises lend themselves to widespread adoption by landless, marginal farmers and women since they require limited land, capital and technical knowhow. With small time inputs, these activities can provide opportunities for rapid and sustained increases in incomes for selected target groups. Under SSI III, these activities would be promoted by IRDP and selected TCCA (paras 4.47-4.54).

3.16 Cargo Transport. Development of private cargo transport enterprises is given priority by GOB. Financing of small scale cargo transport projects would be eligible under the proposed SSI III Credit. Most financing is expected to be in cargo trucks, since investment requirements for water transport are normally beyond the scope of small-scale enterprises. Financing for larger road and water cargo transport projects has been and would be available from development banks like BSB and BSRS. 1/ Under SSI III, up to \$4.5 million (Tk 70 million) or 15% of the subloan component would be available for financing cargo trucks with priority to trucks servicing the fertilizer sector. 2/ For subloans beyond US\$4.5 million, prior IDA authorization would be required, with priority given to fertilizer transport needs. This component would supplement existing credit provided by commercial banks; in 1978, credit to land transport increased by Tk 113 million; total credit outstanding was Tk 452 million. Commercial bank credit, including the proposed credit component, could provide over 50% of the estimated investment requirement for cargo trucks (para 2.15).

IV. THE PROPOSED PROJECT

A. Objectives, Scope and Institutional Arrangements

4.01 The principal objectives of the proposed project would be to increase productivity, earnings, employment and exports in the SCI sector by addressing credit, technical, and marketing constraints in three major segments: (a) organized small industries and cargo transport enterprises serving local markets; (b) exporters and decentralized manufacturers of handicrafts and light industrial products; (c) agro-related rural enterprises; and (d) cargo transport. To meet these objectives, this US\$50 million project would have two major components, with IDA providing US\$30 million for subloans and about US\$5 million for technical and marketing services. 3/

4.02 The project would build on and extend SCI lending capabilities developed within the leading commercial banks under SSI II (Credit 825-BD), incorporating lessons learned from Credit 353-BD (para 1.02). The technical service component would seek to: strengthen promotion and extension services for organized small industries; facilitate links between small enterprises and

1/ BSB and BSRS have available credit lines under which water transport projects are eligible; a second IDA credit to BSB to be prepared in 1980/81 and would give due consideration to demand for credit by medium-scale cargo transport enterprises.

2/ This financial assistance would help the private sector procure spares and transport equipment to meet fertilizer transport requirements as projected under the proposed Fertilizer Transport Project.

3/ Private sponsors would provide about US\$13.08 million equivalent in equity and GOB or the implementing agencies would provide about US\$1.92 million for incremental staff expenditures, land and buildings.

larger manufacturing and exporting firms; and use the rural thana and village cooperative network for rural enterprise promotion. The project would be national in scope. New and existing SCI firms and cooperatives engaged in a wide range of manufacturing, industrial service, transport and agro-related activities would be eligible for credit. Technical services for organized small industries ^{1/} would focus on needs in promising product groups: light engineering; selected agro-industries; finished leather; and wood products. Export promotion and product adaptation efforts for handicrafts and light industries would concentrate on: cane, bamboo and wood items; leather products; specialized textiles and garments; and ceramics. Rural enterprises would be promoted mainly in beekeeping, small livestock, and fish ponds.

4.03 Subloan Component. The major credit institutions would be responsible for subproject appraisal, onlending, supervision, and collections. The three largest commercial banks (Janata, Sonali, and Agrani Banks) and the Bangladesh Shilpa Bank (BSB) would be eligible for initial participation. SCI lending activities would be encouraged and supported by:

- (a) supplying US\$30 million equivalent to help fill the gap between SCI term lending requirements and credit resources available for SCIs (para 4.16);
- (b) establishing an SCI Refinance Unit within Bangladesh Bank to do rapid subproject review and refinance of subloans made by the participating credit institutions to eligible SCIs (paras 4.08-4.12); and
- (c) providing inducements to the credit institutions to increase financing of viable SCIs through differential spreads, an improved credit guarantee scheme, and simplified authorization procedures (paras 4.11, 4.17, and 4.20).

4.04 Technical Service Component. The technical and marketing service component would:

- (a) strengthen BSCIC's promotion and extension services for organized small industries by instituting changes in organization and staffing and by implementing subsector-specific schemes, a subcontracting exchange, and district-level extension programs (paras 4.33-4.39);
- (b) establish common finishing facilities and technical services for small- and medium-scale leather tanneries under the Institute of Leather Technology (paras 4.40-4.42);
- (c) promote expanded exports of light industrial and handicrafts products by establishing an Export and Product Development Program in the Export Promotion Bureau, to finance assistance

^{1/} With fixed assets (original costs) of about Tk 500,000 to Tk 2.5 million.

to exporters through (i) consultancy in product adaptation and supply development; and (ii) participation in sales and exposure trips (paras 4.43-4.46);

- (d) provide technical services, organizational assistance and credit channelling to establish agro-related rural enterprises through IRDP and selected TCCA 1/ (paras 4.47-4.54);
- (e) finance technical assistance for a Planning Commission study to determine potential for rural enterprises and appropriate institutional services (paras 4.55-4.57); and
- (f) strengthen capabilities of the major credit institutions to do appraisal-based lending to SCIs by providing accelerated training of branch level staff of Janata, Sonali and Agrani; establishing a Small Industry Department in Agrani; and providing short-term advisors to help further improve technical appraisal capabilities of the SIDs (para 4.28).

4.05 Financing Plan. Total costs for SSI III would be US\$50 million, of which IDA would provide SDR 26.70 million (US\$35 million equivalent) or 70%. For the subloan component, the IDA US\$30 million equivalent would cover 100% of the refinance of subloan amounts; this would represent an average of 70% of subproject costs, with the remainder coming from sponsors' equity. Under the technical and marketing service elements, the IDA US\$5 million equivalent portion would cover costs of equipment, training, advisors, and trips. GOB's contribution of US\$1.9 million equivalent would cover incremental staff and increased salary expenditures, overheads, and land and buildings for subsector schemes and pilot projects. The following table summarizes project costs and sources of finance:

1/ Integrated Rural Development Program and Thana Central Cooperative Authorities.

Estimated Project Costs /a
(US\$ million equivalent)

	IDA (Foreign)	IDA (Local)	GOB/ Imple- menting Agency (Local)	SCI Sponsors (Local)	Total
<u>Subloan Component</u>	<u>17.20</u>	<u>12.80</u>	-	<u>12.86</u>	<u>42.86</u>
<u>Services and Equipment</u>					
(a) BSCIC-Organized SSIs	0.77	0.64	0.55	0.12	2.08
(b) Institute of Leather Technology	1.05	0.58	0.76	-	2.39
(c) EPB Program	0.60	0.20	0.10	0.10	1.00
(d) IRDP Rural Enterprises	0.01	0.02	0.07	-	0.10
(e) Planning Commission Study	0.20	0.20	0.40	-	0.80
(f) Consultancy and Training-- Bangladesh Bank and Credit Institutions	0.26	-	0.04	-	0.30
<u>Subtotal, Services and Equipment</u>	<u>2.89</u>	<u>1.64</u>	<u>1.92</u>	<u>0.22</u>	<u>6.67</u>
<u>Unallocated</u>	<u>0.47</u>	-	-	-	<u>0.47</u>
TOTAL PROJECT COSTS	<u><u>20.56</u></u>	<u><u>14.44</u></u>	<u><u>1.92</u></u>	<u><u>13.08</u></u>	<u><u>50.00</u></u>

/a A more detailed cost table, with assumptions, is provided in Annex 2, Table 6. Total estimated consultancy costs amount to \$2.83 million covering 454 man-months (average cost of \$6,230 per man-month); IDA would finance \$2.43 million or 86% of total cost and the balance of \$0.40 million would be to the account of the respective implementing agencies (paras 4.09, 4.28, 4.32, 4.35, 4.37, 4.41, 4.43, 4.48, and 4.57).

B. Subloan Component

1. SCI Refinance Unit - Bangladesh Bank

4.06 Bangladesh Bank operates a refinance facility which entitles commercial banks to amounts equal to as much as 5% of their total deposits to help meet the banks' liquidity requirements. Bangladesh Bank also has several specific refinance schemes for commercial banks' advances to the jute, sugar, and export industries. In addition to its normal central banking functions, Bangladesh Bank has special lending schemes for small scale agriculture, industry, and commerce. Refinance on small loans is available under a scheme which sets a target that 2% of each bank's deposits will be used for small enterprise loans of up to Tk 100,000; SCI borrowers are to account for 50% of the target. The IDA Credits complement this scheme.

4.07 Under SSI II, representatives of the Banking Department of Bangladesh Bank chaired meetings of the review committee which screened subloan applications, helped arrange joint appraisals by the banks and BSCIC, and made recommendations to the banks regarding treatment of appraised subprojects. Since the banks have demonstrated satisfactory appraisal skills, they would assume autonomous appraisal and supervision responsibilities under SSI III (para 1.04). The subproject review committee would be disbanded. A Credit Coordinating Committee would monitor implementation of the subloan and related technical service components of SSI III. Bangladesh Bank's experience in industrial refinance and small industry lending operations places it in a strong position to assume a major portion of the subproject review functions performed by IDA under Credit 825-BD. 1/

4.08 In July 1980, Bangladesh Bank established an Industrial Credit Division, with responsibilities for industrial refinance and SCI schemes transferred from the Banking Department. The Industrial Credit Division would include an SCI Refinance Unit responsible for channelling IDA and other funds 2/ for SCI subloans made by the participating credit institutions (para 4.13). This Unit is being established with separate policies, operating procedures, and accounts satisfactory to IDA and initial staff with qualifications and experience satisfactory to Bangladesh Bank and IDA. Under the proposed project, staff of the SCI Unit would perform the following functions for the participating credit institutions: review larger SCI appraisals and refinance eligible subloans; monitor appraisal, supervision and collection standards; organize training programs; collect repayments of refinanced amounts; and report regularly to IDA on SCI lending operations. Bangladesh Bank would make the necessary funds available from its reserves to cover the lag between Bangladesh Bank's refinance of SCI subloan disbursements by the participating banks and its withdrawals from IDA.

4.09 Organization and Staffing. The initial professional staff of the SCI Refinance Unit would consist of an officer-in-charge (Senior Deputy Chief Officer), a Deputy Chief Officer, an Assistant Chief Officer, one accountant (Banking Officer), two engineers and three financial analysts (Banking Officers). This staffing is considered adequate for the first year of operations, commencing by January 1981. Two key staff members are in place; Bangladesh Bank is recruiting the remainder, to enable outside training prior to project implementation.. Additional professional staff, particularly for subproject review, would be required in subsequent years. Financial analysts and engineers would review subprojects and monitor the banks' operations; accounts officers would deal with disbursements, collections, accounting and reporting. Management and staff of the SCI Unit would have qualifications, training and experience acceptable to Bangladesh Bank

1/ Under Credit 825-BD, all subloans above Tk 100,000 have required prior authorization by IDA. Subloans above this limit have represented 96% by amount and 40% by number of subloans.

2/ Other funds would include outside financing of small industries as well as GOB cash foreign exchange allocations for SCI. It would not include funds available under general credit lines to BSB.

and to IDA. 1/ Bangladesh Bank intends to have four to six staff of the SCI Refinance Unit trained in foreign credit institutions with experience in industrial refinance or lending prior to project implementation; GOB intends to request that this training be financed from an IDA Technical Assistance Credit. Funds for foreign training of an additional six staff members would be made available under the proposed project. For the first year of operations, an advisor (12 man-months) would help develop and install detailed operating procedures and train staff of the SCI Unit. Qualifications, terms of reference, and terms and conditions of his assignment would be satisfactory to IDA.

4.10 Policies and Procedures. During negotiations, agreement has been reached between GOB/Bangladesh Bank and IDA on the substance of a draft statement of policies and operating procedures for the SCI Unit. This statement specifies: objectives and eligibility for refinance; review procedures; minimum lending rates and spreads; monitoring responsibilities; and reporting requirements. This agreed statement of policies and procedures, which should form an adequate basis for the SCI Unit's operations, would be adopted by Bangladesh Bank prior to credit effectiveness; any modifications would require IDA approval.

4.11 With the review and refinance mechanism in the Bangladesh Bank and experience gained by the commercial banks and BSB under prior IDA credits, a significant reduction in the proportion of subprojects requiring prior IDA authorization would be justified for Janata, Sonali and Bangladesh Shilpa Banks. Under SSI III, refinance for subloans of up to Tk 500,000 would be granted by Bangladesh Bank on the basis of the credit institutions' appraisals, provided summary statements indicate that financial viability and other eligibility criteria have been met. 2/ Subloans of Tk 500,001-1,500,000, once sanctioned by the participating bank, would require prior authorization for refinance by Bangladesh Bank, with the SCI unit reviewing financial, technical, marketing and economic aspects of the banks' appraisals. Subloans of over Tk 1.5 million would require review and authorization by Bangladesh Bank and IDA prior to eligibility for refinance and withdrawals from IDA.

4.12 To ensure expeditious subproject review, the participation agreements between Bangladesh Bank and the credit institutions would state the intention of the SCI Unit to complete reviews within two weeks. The SCI

1/ The head of the SCI Unit would need to be experienced in industrial credit and refinance. Financial analysts would be business or economics graduates with at least two years of appraisal experience, preferably in industrial credit. Engineers would have at least two years of experience; accounts officer should have proper accounting qualifications.

2/ In requesting refinance for these smaller subloans, participating banks would submit statements listing key characteristics of the subprojects. Appraisal reports should be submitted on a sample basis; SCI Refinance Unit staff and IDA missions would do regular spot checks of sample appraisals, to assure that standards would be maintained.

Refinance Unit would monitor SCI lending activities of the participating credit institutions; quarterly reports from these institutions would be received, reviewed and aggregated for submission to IDA and for discussion in the meetings of the SCI Credit Coordinating Committee. Supervision standards would be monitored through reports and visits to a sample of subprojects.

2. Eligibility, Terms and Conditions

4.13 Eligibility for Refinance. Credit institutions eligible for refinance would be those which have signed a participation agreement with the Bangladesh Bank acceptable to IDA (para 4.22). Sonali, Janata, Agrani and Bangladesh Shilpa Banks would be eligible for initial participation under SSI III, since these institutions have relatively sound overall operations and would have taken the necessary steps to provide adequate staff for SCI lending operations. While inclusion of these four credit institutions would provide an adequate nationwide SCI lending network 1/, GOB is interested in making Rupali Bank, the fourth largest commercial bank, eligible for refinance under SSI III. Participation by Rupali or other banks would be possible if Bangladesh Bank and IDA agree that the concerned bank has established an adequate number of qualified staff for its SID at headquarters, launched a substantial program for training staff of key branches and signed a participation agreement with Bangladesh Bank, satisfactory to IDA.

4.14 Subprojects eligible for refinance would involve the establishment, balancing or expansion of private or cooperative enterprises 2/ involved in manufacturing, processing, repair, handicraft production, cargo transport, or agro-related activities such as fish ponds, beekeeping, and small livestock. Enterprises not eligible would include: hotels, restaurants, cinemas, wholesale and retail operations, storage, construction contractors, 3/ and clinics.

4.15 Economic eligibility criteria employed under Credit 825-BD would be maintained under SSI III. Eligible firms would be those which, in addition to being financially viable, meet the following criteria: (a) fixed costs per job not exceeding Tk 50,000 equivalent; and (b) raw materials or inputs of local origin or involving prior local processing constituting not less than 60% of the total value of raw materials in the case of industries serving local markets. Firms catering to export demand would need only to provide evidence that they would be net foreign exchange earners. These eligibility

1/ Sonali, Janata and Agrani Banks account for over 70% of the branches and total lending operations by the commercial banks.

2/ Cooperative and private enterprises promoted by such organizations as the Ministry of Women's Affairs, Ministry of Youth Development, local governments and private voluntary organizations would be eligible for credit on the same terms and conditions as other individual SCI subprojects.

3/ Construction contractors would not be eligible for credit under SSI III since financing needs and appropriate appraisal techniques differ significantly from those of manufacturing and industrial service enterprises.

criteria, while rough, have proven useful in inducing the banks to select projects of higher economic merit. However, specific exceptions would be made. Cargo transport enterprises, which have considerable economic impact, would not be expected to meet either raw material or labor intensity criteria. Engineering firms which require metal not processed locally would be eligible enterprises, since these firms tend to be key industries with strong linkages to other economic development. In the case of other subprojects which the banks and Bangladesh Bank judge to have high economic merit but which do not meet the economic eligibility criteria, the banks would need to provide economic as well as financial justification and submit the subprojects for prior authorization by IDA.

4.16 Size and Allocations - Subloan Component. The subloan component would be US\$30 million equivalent, with total subproject costs of about US\$43 million equivalent including the 30% equity contributions by private sponsors. 1/ The expected commitment period would be about 24 months. 2/ To assure access to credit by smaller, export-oriented, and rural enterprises, the following allocations of the subloan component would be made:

- (a) A maximum of 60% (about US\$18 million equivalent) of the sub-loan component would be available for financing sub-projects with fixed costs of above Tk 1 million each 3/;
- (b) Up to 15% (about US\$4.5 million equivalent) would be available for cargo transport without prior IDA review; additional amounts would be available, subject to prior review by IDA 4/;
- (c) A minimum of US\$1 million equivalent would be provided for term credit to exporters of handicraft and light industrial products and related SCIs (para 4.44); and
- (d) A minimum of US\$1 million equivalent would be provided for rural enterprise loans through eligible TCCA (para 4.49).

1/ In case of subloans of up to Tk 500,000 the equity contributions could be reduced to minimum 20% of the subproject cost.

2/ Monthly commitments are expected to average US\$1.25 million, which is reasonable in view of SCI demand for credit and the present monthly commitment rate of about US\$800,000 by Janata and Sonali, under Credit 825-BD.

3/ Agreements between Bangladesh Bank and the participating credit institutions would provide that each bank maintains these ratios. Compliance would be reviewed periodically.

4/ Priority would be given to transport requirements of the fertilizer sector.

4.17 Refinance Arrangements. Bangladesh Bank would refinance 100% of eligible disbursements on approved subloans made by the participating banks under the proposed IDA Credit. IDA would reimburse Bangladesh Bank for 100% of these eligible disbursements. 1/ The maximum size of a subloan would be Tk 3.0 million or 70% of subproject costs whichever is lower. Subloans of up to Tk 500,000 could, however, constitute up to 80% of total subproject costs. The credit institutions would assume full repayment risks on refinance, repayable to Bangladesh Bank with maturities matching those of subloans financed.

4.18 GOB, which would bear foreign exchange risks, would onlend funds to Bangladesh Bank at a minimum of 2.0-5.0%. Bangladesh Bank would receive a 2% spread, 2/ which has been calculated to be adequate to cover administrative and financial costs of this SCI refinance facility and the related revolving fund. To help assure that a significant portion of the project's resources are made available to smaller SCIs, the credit institutions would receive differential spreads, designed to cover larger administrative costs incurred as a proportion of smaller subloans. The refinance rate would be adjusted to provide the following minimum spreads to the participating banks: (a) 8% p.a. on subloans of up to Tk 500,000; (b) 7% on subloans of Tk 500,001 to Tk 1.5 million; and (c) 6% of subloans of Tk 1.5 million to Tk 3 million. These spreads have been designed to cover the banks' appraisal, loan processing and supervision costs for SCI lending operations, provide coverage of risks and induce the banks to give increased attention to SCI project-based lending. In cases in which the credit institutions choose to participate in the credit guarantee scheme of Bangladesh Bank (para 4.20), the 1% premium on the guaranteed portion would be taken out of the spread of the responsible credit institution. The table below summarizes interest rates and tiering of spreads, assuming a minimum onlending rate to SCIs of 13%:

	<u>Subloans of up to Tk 500,000</u>	<u>Tk 500,001 to Tk 1,500,000</u>	<u>Tk 1,500,001 to Tk 3,000,000</u>
(a) <u>IDA Charge</u> <u>3/</u>	0.75%	0.75%	0.75%
(b) <u>GOB Charge</u>	3%	4%	5%
(c) <u>Bangladesh Bank Spread</u>	2%	2%	2%
(d) <u>Commercial Banks and BSB Spread (without guarantee)</u>	8%	7%	6%
(e) <u>Minimum Rates to SCIs</u>	13%	13%	13%

In the case of subloans made by the participating credit institutions through TCCA and village-level cooperatives, the minimum 13% final onlending rate

1/ Under Credits 353-BD and 825-BD, IDA disbursed against 100% of the bank's subloans, which is still justified in view of the liquidity position of the banking system.

2/ Except for subloans through TCCA, where the spread would be 1% (para 4.18).

3/ IDA charge is included in GOB's charge to Bangladesh Bank.

would be maintained. The spread arrangements would be adjusted to cover costs by the TCCA and village-level cooperatives, which would have major responsibilities in: preparing and aggregating subloan applications for several cooperatives in the TCCA; supervising; collecting; and providing technical services. The interest rates and spreads would be:

(a) Charge by GOB	2%
(b) Spread to Bangladesh Bank	1%
(c) Spread to Credit Institutions	4%
(d) Spread to TCCA	3%
(e) Spread to Village Cooperative	3%
(f) Minimum rate to SCIs	13%

4.19 Terms and Conditions. The present 11.5% interest rate for SCIs, represents a negative real rate of interest. GOB has indicated that general interest rate levels were under active review, with the intention of increasing rates to reflect inflation projections. The final on-lending rate for SSI III would be not less than 13%. In view of the inflation projections for 1980/81 (para 2.17) this rate would be positive in real terms. Consultations on the interest rate would be undertaken between GOB and IDA at least once a year. Maturities on subloans for fixed assets would be 2 to 12 years, including grace periods of up to 3 years. Subloans for working capital and transport equipment would have 2 to 5 year maturities, including grace periods of up to 3 years; cargo transport operations are sufficiently profitable for a 5 year repayment period, and SCIs should be in a position to locate normal commercial loans for working capital requirements after an initial 5 years of operations. 1/

4.20 Credit Guarantee Scheme. Under SSI III, Bangladesh Bank would continue to operate its SCI credit guarantee scheme with certain modifications made. The scheme would be voluntary; in cases in which the banks choose to have subloans covered, 1% on the amount guaranteed would be paid to Bangladesh Bank. Guarantee coverage would be 75% on subloans of up to Tk 500,000 and 50% on subloans of above Tk 500,000. Subloans approved for refinance by Bangladesh Bank would be automatically eligible for coverage under the credit guarantee scheme. Amendments in Bangladesh Bank's existing credit guarantee scheme would be needed prior to effectiveness of SSI III; the changes, outlined in the project file, would need to reflect the banks' autonomous appraisal responsibilities, the tiering of guarantee coverage according to subloan size, the voluntary nature of the scheme, and the automatic eligibility for guarantee coverage of subloans approved for refinance by Bangladesh Bank. 2/

4.21 Institutional and Training Needs. Prior to credit effectiveness, Bangladesh Bank would need to:

1/ As agreed under SSI II, working capital loans would be to finance initial raw materials and/or spares in connection with a proposed subloan for acquisition of fixed assets by an SCI enterprise; incremental working capital for expansion projects would be eligible.

2/ Except for the differential coverage of 75% for smaller loans which could take more time since the approval of Parliament would be required.

- (a) establish an SCI Refinance Unit with accounting practices, a statement of policies and operating procedures and management and staff satisfactory to IDA (paras 4.08-4.12);
- (b) establish participation agreements with at least two participating credit institutions, satisfactory to the involved parties and to IDA (paras 4.12, 4.13 and 4.22); and
- (c) make necessary changes in the credit guarantee scheme (para 4.20).

3. Participating Credit Institutions

4.22 The participation of the commercial banks and BSB would be governed by individual agreements with Bangladesh Bank. These agreements would outline terms and conditions of the SSI III including: eligibility criteria; 1/ refinance procedures; approval authority; appraisal standards; supervision, procurement, disbursement and reporting responsibilities; staffing and training requirements (para 4.13). Agreement has been reached between GOB and IDA on the substance of a draft Participation Agreement between Bangladesh Bank and Participating Credit Institutions.

4.23 The Commercial Banks. Sonali, Janata, and Agrani Banks are the three largest commercial banks in Bangladesh with combined total assets of Tk 28.6 billion as of December 31, 1978. These banks account for over 70% of total commercial bank deposits, advances, and branches. Most of the banks' outstanding advances are short term; lending decisions are still based largely on clients' collateral, although security requirements have been relaxed in cases of project-based lending to SCIs. Under Credit 825-BD, Sonali and Janata have established Small Industry Departments (SIDs) to handle their term lending operations to SCIs; these SIDs have attained satisfactory appraisal capabilities, and have adopted adequate follow-up and reporting procedures. Agrani would strengthen its SID prior to its participation in SSI III.

4.24 Sonali Bank. Sonali is the largest commercial bank in the country with total assets of Tk 11.8 billion and 709 branch offices as of December 31, 1978. Sonali's total income was Tk 463.2 million and net profit was Tk 34.9 million; with a net worth of Tk 80.0 million, return on equity was 44%. Of its total advances of Tk 4.8 billion outstanding, industrial lending accounted for 37%; only Tk 2.6 million or 0.5% were in term loans to small industries. Sonali's SID has 24 officers 2/ trained in SSI operations and industrial appraisal methods; 35 small industry specialists, assigned to district branches, have attended SCI lending courses sponsored by the Bangladesh Institute of Banking Management (BIBM). Sonali plans to accelerate training of branch officers to facilitate processing of small loans. Under SSI III, subloans of

1/ The Statement of policies and procedures of the SCI Unit and strategy statements of participating institutions would spell out priority financing of fertilizer cargo transport.

2/ 3 engineers, 4 MBAs, 2 economists, 15 accountants.

up to Tk 500,000 would be refinanced automatically if financial viability and other economic criteria are met; this limit is within the approval authority of branch managers. Sonali is the bank most active with agricultural, commercial and industrial loans channelled through TCCA. Sonali is expected to handle most of the loans to the TCCA under the proposed Credit (para 4.16).

4.25 Janata Bank. Janata is the second largest commercial bank, with total assets of Tk 11.2 billion and 629 branches at the end of 1978. Total advances were Tk 5.4 billion; industrial advances accounted for about 26%. Total income reached Tk 859.4 million resulting in a net profit of Tk 29.7 million or 33% of net worth. Under Credit 825-BD, Janata has established an SID at headquarters with 25 officers ^{1/} who have received training in SCI lending operations or industrial appraisal methods; 28 district branch officers have attended SCI courses at BIBM. Janata would accelerate training of branch SCI officers under SSI III. A consultant would be assigned to Sonali and Janata for three months each to assist in the improvement of the banks' institutional capabilities in development financing of SCI enterprises. The consultant's qualifications and terms of reference would be satisfactory to IDA. Sonali and Janata are expected to process about 300 subprojects each; about 200 subprojects or about 60% of these would have loans below Tk 500,000.

4.26 Agrani Bank. Agrani is the third largest commercial bank in Bangladesh with total assets of Tk 5.6 billion at the end of 1978, about half those of Sonali or Janata Banks. However, Agrani has 602 branches which is extensive for its asset size. Industrial advances were about one-third of total advances; its total income was Tk 273.5 million; net profit was Tk 17.3 million or 27% of net worth. To date, Agrani's long term lending to SCIs has been limited to projects under IDA Credit 353-BD and other GOB foreign exchange credits; under these, Agrani depended on appraisals by BSCIC. Agrani has set up a small enterprise unit headed by an assistant general manager with training in industrial credit. As a condition of participation under SSI III, Agrani would strengthen its SID with an initial full time staff of eleven officers: one manager, two engineers, six analysts, and two administrative officers. These officers would undergo appropriate training in SCI appraisal methods and lending operations. In addition, a consultant would be assigned to the SID for 6 months to help Agrani establish strong appraisal and supervision capabilities. The consultant's qualifications and terms of reference would be satisfactory to IDA.

4.27 Bangladesh Shilpa Bank. BSB is an institution specializing in term loans to industry. As of June 30, 1979 its total assets were Tk 2.5 billion. Its net profit of Tk 22.2 million represented 7% of its net worth. BSB has fully utilized its first IDA Credit of US\$25 million for financing medium and small enterprises and it is envisaged that a second IDA Credit of about \$50.0 million would be considered in 1980/81. Although BSB has no floor on the size of its industrial loans, its financing of small industries has been mainly in the upper range with loans of Tk 1.0 million to Tk 2.5 million. Under its ADB loan approved in June 1979, US\$4.0 million is earmarked for

^{1/} 6 engineers, 7 MBAs, 3 economists, 9 accountants.

small industry. BSB can benefit from the spread arrangements, GOB coverage of the foreign exchange risks, and the SCI Credit Guarantee under SSI III. With its participation under SSI III, BSB intends to expand its SSI operations by training its branch staff to undertake appraisal of SSI projects. BSB has satisfactory appraisal capabilities, but would need to provide its SSI lending strategy and staffing as part of its participation agreement with Bangladesh Bank; this would be contained in BSB's revised strategy statement.

4.28 Institutional and Training Needs. To ensure satisfactory subproject review and refinance capabilities by Bangladesh Bank and strong appraisal and supervision standards by the participating credit institutions, SSI III would finance:

- (a) an advisor to the SCI Refinance Unit of Bangladesh Bank for 12 months (para 4.09); 1/
- (b) six mammonths of consultancy to help Agrani establish its SCI operations and 3 mammonths each for Janata and Sonali Banks, to assist the SIDs in strengthening technical appraisal knowhow (paras 4.24-4.26); and
- (c) outside training for about 6 officers of the SCI unit of Bangladesh Bank and about 16 SID officers from the participating credit institutions.

C. Technical and Marketing Component

4.29 Elements of the technical service component, outlined in para 4.04, are structured to address problems blocking rapid growth in four major SCI segments: organized small industries catering to local markets; export-oriented light industrial and handicraft manufacturers and exporters; agro-related rural enterprises; and cargo transport. As outlined in Chapter III, assistance needs and the appropriate service institutions differ for these three major groups.

1. Services for Organized SSIs - BSCIC

4.30 Experience under Credit 825-BD. BSCIC has taken some steps to improve promotion and extension services. Under Credit 825-BD, BSCIC established a Promotion and Extension Division with a Director overseeing the work of the Counselling and Industrial Services Department and the Industrial Extension Services Department (IESD). The necessary methods and materials for successful promotion and extension progress have been developed (para 1.05). However, progress has been slow in using these tools for active and systematic promotion and extension work. At the district level, Industrial Estate

1/ This advisor would also study and make recommendations on the operations of the Bangladesh Institute of Bank Management (BIBM) in terms of organization, staffing and course programs for SCIs.

Managers have been renamed District Managers but no full time extension officers have been posted to district offices. Moreover, District Managers still report to the office at headquarters responsible for industrial estate operations; training of extension officers has been insufficient to enable them to do effective extension work; and district-level activities have remained concentrated on the industrial estates, which contain a small fraction of organized SSIs.

4.31 Basic problems hindering BSCIC's effectiveness include: (a) management with insufficient motivation, industrial experience, and tenure with BSCIC; (b) an unclear mandate from GOB; (c) diffusion of activities; and (d) insufficient numbers of trained and motivated promotion and extension officers at the district level or subsector specialists to provide back-up services. Key GOB officials are concerned with the weaknesses in BSCIC's performance; the Second Five Year Plan indicates commitment by GOB to institute substantial changes in programs, organization and staffing to enable BSCIC to be more effective in its primary tasks of promotion and extension services for organized small industries.

4.32 Strategy. Elements of SSI III to be implemented by BSCIC deal with the major organized SSI product groups, utilizing subsector analysis performed under Credit 825-BD. These elements attempt to accelerate growth in light engineering, woodworking, selected agro-industries and garments; promote links between SSIs and public corporations, through the establishment of a subcontracting exchange; finance pilot projects involving BSCIC and private sponsors in setting up new types of enterprises; and strengthen decentralized promotion and extension services. While the success of other project elements would not be impaired if BSCIC's performance does not improve 1/, the project elements to be performed by BSCIC would need to be accompanied by substantial improvements in strategy, organization and staffing to help ensure successful implementation. The following steps would need to be taken by January 31, 1981:

- (a) allocation by GOB of finance for addition of 80 promotion and extension officers in the district offices over a three year period. At least 50% of these officers would be assigned during 1980/81; 2/
- (b) launching by BSCIC of a three year program of intensive ongoing formal and field-level training for these promotion and extension officers, with outside technical assistance. Twenty-four man-months of consultancy funds for BSCIC were provided under SSI II for promotion and extension work; this

1/ While promotional services for SCIs would enhance credit demand, the US\$30 million provided under the project would fall well below potential demand for credit by SCI (paras 2.13-2.16); utilization would not be dependent upon the success of BSCIC's promotional or extension progress. Also, the export promotion, rural enterprise and leather development programs would be operated independently of BSCIC's services.

2/ Outlines of the decentralization plan and the training program are available in the Project File.

and additional consultancy to carry out training work ^{1/} would form the basis for the training program agreed in substance during negotiations;

- (c) installation of a system which provides inducements for qualified and motivated staff to work in the districts, while replacing less efficient staff through attrition and increasing the ratio of technical to non-technical staff;
- (d) organization of subsector cells at headquarters with adequate staffing to provide the necessary backup for district extension officers and to develop and implement subsector schemes; and
- (e) formal commitment by BSCIC to substantial private sector involvement in ownership and management of pilot projects.

Other major steps recommended to increase BSCIC's effectiveness include:

- (a) reducing the focus on physical investments by BSCIC, having BSCIC utilize existing prototype development facilities and avoid additional investments in industrial estates and centralized training facilities which are costly, have limited demand outside major industrial areas, and cause BSCIC to limit its target group of clients; and
- (b) getting BSCIC to focus on fewer activities, giving priority to those with high impact on organized SSIs; in cottage industries, get BSCIC to focus on training the trainers from organizations with established rural networks rather than developing BSCIC's own direct support capabilities.

These recommendations were discussed with BSCIC and concerned ministries during appraisal. Top ministry officials agreed in principle; BSCIC management demonstrated reluctance to make these fundamental changes, but a new chairman is being selected. GOB submitted during negotiations the revised draft administrative scheme of BSCIC for the Second Five Year Plan Period. With the introduction of the above modifications, the administrative scheme, would provide the basis for significant improvements in BSCIC's organization, staffing and training.

4.33 Decentralization. Under SSI III, BSCIC would expand its extension staff in district offices. District level extension staff would: identify clients requiring technical or managerial advice; diagnose their problems; recommend solutions to more common difficulties; refer special cases to headquarters; and monitor clients' progress. During negotiations, a draft action plan for this expansion and related staff training was developed with BSCIC. The draft plan encompasses the addition or redeployment of about 40 technical staff in 14 district offices in year 1 and another 40 technical staff for six offices in Years 2 and 3. Staffing of these district offices

^{1/} It is envisaged that, upon request from GOB, additional funds would be provided for this purpose under an IDA Technical Assistance Credit.

would vary according to existing and potential industrial concentrations: two offices with seven professionals each, nine offices with five professionals each, and twelve offices with three professionals each are envisioned. The recruitment and redeployment of staff would need to be accompanied by: (a) an intensive and continuous training program; (b) changes in reporting relationships, with district managers reporting to the Director of the Promotion and Extension Division; and (c) a system of rewards to encourage qualified staff to assume positions outside Dacca and to reward strong performance (para 4.32). Staffing and training commitments and organizational changes would need to be made by January 31, 1981.

4.34 Subsector Organization at Headquarters. The Industrial Extension Services Department (IESD) of the Promotion and Extension Division would be reorganized along subsector lines to provide technical backup services for extension workers in the districts and to develop subsector schemes. Initially, cells would be established in the following four subsectors: light engineering with emphasis on manufacture and repair of agricultural implements; agro-processing with a focus on fruits and vegetables; woodworking; and garments. A minimum of two engineers or technologists would be needed in each subsector.

4.35 SSI III would finance outside specialists, assigned to each subsector cell for 24 manmonths each to assist in establishing backup technical service capabilities and subsector specific schemes, involving the headquarters cells and the network of field extension officers. Each consultant would assist in developing the BSCIC engineers or technologists as subsector specialists at headquarters. Each subsector team would make a quick sample survey and develop a practical program for promoting and assisting firms in the subsector. In addition to providing direct technical assistance and training, the consultant would prepare a medium and long term assistance scheme to be carried out by BSCIC. Also, the consultant would help develop coordination and referral mechanisms between BSCIC and other agencies which can assist the subsector. The outside subsector specialists would start only once BSCIC has reorganized headquarters into subsector cells and finished recruitment, training and fielding of the first batch of district extension officers. These steps are expected to be completed by January 31, 1981. Costs for these subsector specialists would be about US\$670,000. Selection of consultants would be satisfactory to IDA based on qualifications and draft terms of reference which were discussed with BSCIC at appraisal and were agreed in substance at negotiations.

4.36 Subcontracting Exchange. Under SSI III, BSCIC would establish a subcontracting exchange within the IESD, to facilitate manufacture of spares and components by SSIs for sale to public sector corporations. Major functions of the subcontracting exchange would be to: organize data banks on the corporations' requirements and SSI capabilities; help small industries get orders; and assist the SSI subcontractors in making improvements in methods to assure quality and timely deliveries. In some cases, the exchange would need to supply blueprints and help SSIs locate proper jigs and testing equipment. Initially, the exchange would focus on the metal products subsector. A recent survey sponsored by BSCIC provides a strong data base on specific capabilities of most organized engineering SSIs for use in operating the subcontracting exchange.

4.37 BSCIC's subcontracting exchange would focus on the needs of four major public sector corporations: BJMC, BTMC, BSFC and BCIC. Management of each of these corporations has agreed to assign at least one full time engineer to work with BSCIC on: developing information on product groups for manufacture by local SSIs, and providing backup services from the corporations in supplying specifications, quantity and delivery requirements, and quality testing facilities. BSCIC's subcontracting exchange would be staffed by one senior development officer, two deputy chief engineers, four engineers and eight support staff. At GOB's request, funds from the IDA Technical Assistance Credit could be utilized for two to three months of training and exposure in India for 2 to 3 IESD staff members assigned to the subcontracting exchange. Three months of consultancy funds allocated for BSCIC under SSI II would be utilized for a subcontracting specialist whose work would complement that of IESD staff helping to establish the subcontracting exchange. GOB would cover staffing costs; the IDA portion of SSI III would total about US\$200,000 covering establishment costs for the exchange (US\$35,000), nine months of the advisor (US\$54,000), studies by local engineering consultants on those public corporation requirements which can best be met by engineering SSIs (US\$36,000), and hiring of engineers on a fixed contract basis to assist specific SSIs in establishing stable subcontracting (US\$75,000).

4.38 Pilot Projects. BSCIC plans to sponsor a series of pilot projects during the Second Five Year Plan period; these are intended to be productive enterprises in new product lines to test and demonstrate project viability and promote replication by private entrepreneurs. Pilot projects can be powerful tools in introducing new types of enterprises, since many entrepreneurs prefer to copy successful activities rather than experiment with new ones. However, BSCIC has sponsored a number of unsuccessful pilot projects, due to lack of technical knowhow, commercial incentives and management capabilities. The appraisal mission strongly recommended that major expenditures on pilot projects be made only when: (a) a private partner, with relevant managerial or technical experience, is willing to take a share in management and investment from the outset ^{1/}; (b) the project, while potentially profitable, requires testing prior to normal private sector investment; and (c) the pilot project has good prospects for replication (para 4.32).

4.39 BSCIC plans to promote some small-scale projects which have been pioneered and found commercially viable by the National Small Industries Corporation Ltd. (NSIC) of India. Proposals have been provided for technical collaboration by NSIC in pilot plants in rice husk, ash cement, handmade paper, and rubber erasers. Feasibility studies on the first two indicate that the projects are feasible and sound within the Bangladesh context. IDA funds have been allocated for about ten pilot projects with equipment costs averaging

^{1/} BSCIC's participation in these pilots could help assure that the projects serve their broader demonstration purpose, while the private entrepreneurs' role would be to provide management and a means for evolution into a fully private enterprise.

US\$30,000 and 6 months or roughly US\$24,000 of technical assistance 1/ per project. Prior to IDA authorization of expenditures for these projects, BSCIC would submit: the technical and economic feasibility study; a description of how the proposed project meets eligibility criteria outlined in para 4.38; composition of managerial and technical staff; ownership structure; 2/ action program for implementation of the pilot; and the plan for phasing out BSCIC's involvement, with the project if successful becoming completely private after serving its demonstration purpose.

2. Services for Private Sector Tanneries

4.40 SSI III would help establish a program to provide common finishing facility and technical services for small- and medium-scale tanneries under the Institute of Leather Technology (ILT). The facilities and services would be owned and operated by ILT, under a management committee which would include representatives of small private tanneries. Active private participation in management would help ensure proper selection and use of the necessary equipment. The management committee would have about six members with at least two from the private sector; the principal of the Institute would serve as the chairman. The ILT is in Hazaribagh in the heart of Dacca's tannery concentration; the Institute has strong contacts with private tanneries and technical knowhow useful in developing the industry. The finishing facilities could be established on the premises of the Institute. The finishing facility, which would be used exclusively for private tanners, would have a full-time plant manager and skilled operators. The finishing facility would not be used for training purposes; graduates of ILT's training programs would use the equipment only when the principal has determined that they are skilled operators.

4.41 Main functions of the common facilities center would be to provide at commercial rates: (a) common hide finishing facility services to private tanneries of Hazaribagh, in the area surrounding the ILT; (b) technical services for private sector tanneries including laboratory testing and quality control and (c) effective in-plant consultancy services with the assistance of consultants. A two phase system would be adopted. Consultancy for technical services would be made available immediately. Half of the total equipment costs would be made available during year 1 of operations; this would be sufficient to finish about 500 hides daily. After 18 months, there would be a joint review by the Ministry of Education, ILT and IDA to determine the extent to which smaller tanneries have been helped and the optimum investment of remaining funds. Estimated costs would include: common facilities with capacity of 500 hides per day (US\$1.3 million); 48 man-months in advisors for training in tanning and for assistance in managing the common facilities; and improvement and expansion in the existing building, and permanent working capital.

1/ From NSIC or other sources.

2/ In the year 1 action plan for BSCIC, a formal statement would be included specifying that all pilot projects would have at least 10% private investment with a major share in management by the private partners.

4.42 Prior to disbursements for this component (a) the local manager and consultant for the common facility would need to be appointed and (b) the action plan for year 1 would need to be adopted in a manner, satisfactory to IDA. Each January 1, ILT would furnish to IDA and thereafter carry out an annual action plan taking into account IDA's comments thereon.

3. Export Promotion Bureau Program

4.43 As noted in para 3.08, major promising product lines for export expansion 1/ include: leather and leather products; specialized textiles and garments; cane and wood furniture; ceramics; bamboo, jute and other handicrafts. Exporters already play an important role in organizing production from household and other small enterprises. SSI III would provide funds to assist exporters in improving the quality, and value added of these products. Banglacraft and other exporters associations are being established to help channel assistance to exporters of handicraft and light industrial products. Under SSI III a Handicraft and Light Industrial Export and Product Development Program would be established within the Export Promotion Bureau to:

- (a) fund practical consultancy services to assist exporters in: developing and adapting products; improving quality, productivity and organization of the decentralized production base; and contacting potential buyers (about US\$400,000 equivalent); and
- (b) finance exporters' and manufacturers' participation in sales trips, fairs and visits to exporters and producers in neighbouring countries which are successful exporters of similar items (about US\$400,000 equivalent).

4.44 These technical and marketing services, 2/ organized by EPB, would constitute an important complement to the proposed allocation of US\$1.0 million of the subloan component to handicraft exporters and related manufacturers (para 4.16) 3/ under which they would be eligible for term credit from participating banks to finance processing and packing facilities and tools and inputs for artisans in the exporters' networks.

1/ With improvements in market contacts, product adaptation, and supplies, EPB anticipates that annual export value of leather and leather goods could increase by about 50% by 1984/85; minor industrial exports (mainly light industrial and handicraft products) could increase by over 160% from present annual exports of Tk 480 million during the same period.

2/ The Bangladesh Handicraft Marketing Corporation, a subsidiary of BSCIC, would be eligible for this funding of consultancy and trips.

3/ This US\$1.0 million would be a special allocation for exporters and related manufacturers; once this allocation is fully utilized, exporters would be eligible subborrowers under the general subloan component of SSI III.

4.45 Organization. The Export Promotion Bureau has strong experience in hiring consultants to provide product adaptation advice to exporters, and organizing exporters' participation in trade fairs. Recently the EPB used a U.S. marketing consulting firm to organize a successful single country fair between Bangladesh and the United States, with intensive product adaptation and supply development work preceding the fair. EPB intends to utilize a sizeable portion of the SSI III component to repeat this package in entering other promising markets. Staff requirements for this activity would be small; EPB intends to use existing and a few additional specialized local staff to organize consultancy and exposure trips. Concentrated assistance would be given in the product groups mentioned in para 4.43 although other handicraft and light industrial product lines also would be eligible.

4.46 Simplified procedures. Given the experience of the EPB and the need to retain flexibility, IDA authorization and disbursement procedures would be kept simple. By January 31, 1981, the Program would need to be established with appropriate policies and procedures, a year 1 action plan having been furnished to IDA for its concurrence, 1/ and adequate staff to administer the Program. Within these general guidelines and annual action plans, EPB could operate flexibly, informing IDA when major changes in the program were made. EPB in consultation with client export associations would select consultants, with EPB establishing terms of reference and contractual conditions. The EPB would approve qualifications and terms for individual consultants. By January 1 of each year, EPB would furnish to IDA and thereafter carry out an action plan taking into account IDA's comments. The EPB would submit quarterly reports to IDA on actual use of the Program including a detailed description of participation in and costs of sales and exposure trips and curriculum vitae, terms of reference and terms for consultancy services. EPB would also maintain separate accounts for the Program. IDA would disburse against regular statements of actual expenditures for incremental expenses under this program. GOB would allocate sufficient funds to EPB to cover the lag between EPB's expenditures and withdrawals from IDA.

4. Rural Enterprise Development - IRDP

4.47 Under SSI III, IRDP and selected, stronger TCCA would promote agro-related rural enterprises, such as beekeeping, goat rearing, pond fisheries, poultry and certain agro-processing activities. While most activities of IRDP and the TCCA focus on agricultural development, IRDP has launched a program promoting rural women's cooperatives; the most successful activities of these cooperatives are agro-related, building on skills of IRDP and villagers. The cooperative organization of TCCA and village level KSS 2/ represents virtually

1/ The statement of policies and procedures would include objectives and uses of the program; priority product groups and target markets; ranges in consultancy fees and trip payments; and disbursement and reporting arrangements.

2/ Thana Central Cooperative Authority (TCCA) and village cooperatives (KSS).

the only rural service infrastructure in Bangladesh. It is appropriate that IRDP build its capabilities in agro-related rural enterprises, since its major objectives are productivity and income improvements in rural areas, which are needs that cannot be addressed fully through agriculture. While many TCCA have difficulty managing their primary agricultural activities, IRDP has graded TCCA into categories, the best of which could be encouraged to diversify into promoting secondary rural enterprise activities. Under the proposed rural enterprise component, 10 to 15 of the more successful TCCA would be selected to channel credit and technical services for concentrated product and area rural enterprise schemes involving landless and marginal farm families.

4.48 Organization and Staffing. While IRDP is the best suited agency in Bangladesh to implement this type of agro-related village enterprise component, IRDP has had management difficulties and needs to continue in its new drive to consolidate and strengthen its existing activities. The rural enterprise component is structured to have a sizeable impact on income generation for the rural poor, while minimizing burdens on IRDP. IRDP would supplement its rural enterprise department at headquarters with about 4 additional staff. IRDP's major tasks would be to organize training of about 35 TCCA rural enterprise supervisors over a three year period and monitor progress of the program. An advisor would assist IRDP in: launching year one of the program; making detailed plans for years 2 and 3; and installing a simple monitoring and evaluation system. With a small number of the strongest TCCA involved, most tasks could be decentralized.

4.49 Summary of Schemes. Technical, financial and market feasibility has been assessed for beekeeping, pond fisheries, goat rearing and poultry. As indicated below, these activities can be profitable and need not be dependent upon subsidies. Tentative selection of thanas has been made, based upon field work and records of IRDP rural enterprise staff. Selection criteria for the schemes vary according to infrastructure, resource and skill requirements and concentrations of landless and marginal farm families; all thanas selected would have strong performance records in agricultural programs and loan repayments. To the extent that the location of successful TCCA and the needed conditions permit, activities would be concentrated in a fairly compact area to facilitate implementation and supervision. In each case IRDP would organize selection and training of the TCCA supervisors, who would: promote establishment of cooperatives of landless, marginal farmers, and women applying eligibility criteria on maximum holding and incomes of beneficiaries; provide these cooperatives with technical services; and help prepare loan applications. The TCCA would group loan applications for a number of cooperative enterprises in the TCCA, presenting the consolidated application to one of the participating commercial banks. The TCCA would receive a spread of 3%; the KSS or specialized cooperative would receive 3%. These spreads are adequate to cover costs incurred by preparing loan applications, distributing the subloans to the cooperatives, supervising utilization, collecting repayments, and providing technical services. Major features of the four principle schemes are outlined below. 1/

1/ More detailed descriptions and analyses are available in the project file.

4.50 Beekeeping schemes would be implemented in four to five thanas over the three year implementation period. Criteria for TCCA selection would be: strong TCCA management and a good record in agricultural programs; appropriate vegetation to support beekeeping; and some beekeeping tradition. The local market for honey is strong; prevailing prices are high. Beekeeping requires limited capital investment of about Tk 250 per modern hive, no working capital and little work for farm families. In year 1, yields can be expected to be at least Tk 350 per hive; in year 2 and after, annual yields are normally Tk 1,000 per hive. Honey could be sold locally, with extraction equipment costing about Tk 500 shared by the village cooperative; when higher yields are achieved, honey could be collected by a TCCA level cooperative for packaging and sales in urban areas. With an estimated 180 cooperatives of about 20 members each formed over a three year period, about 3,600 families would benefit. With an average of two hives per participating family by year 3, annual incremental earnings would be roughly Tk 2,000. With each TCCA supervisor providing organizational and technical services to 10 beekeeping cooperatives for the initial two years, it would be necessary to have about 15 TCCA supervisors by year 3. Estimated credit requirements are Tk 12,000 per cooperative, or a total of Tk 2.2 million.

4.51 Goat rearing is an established and profitable activity of rural women in Bangladesh. Goats scavenge, requiring no purchased feed; risks of loss due to disease are relatively low. A unit purchasing three goats for about Tk 330 could earn roughly Tk 1,500 by the end of year 1 and up to Tk 7,000 in year 2. About six thanas would participate in years 1 and 2 of this program. Three thanas from Jessore, one adjacent thana in Khulna, and two in Dacca have been tentatively selected. Selection criteria include: strong TCCA management and an operational women's cooperative program. An estimated 20 cooperators could participate from each village at the outset. By year 3, it should be possible to cover about 250 village cooperatives, with investment requirements totalling roughly Tk 3.0 million and credit requirements of Tk 2.1 million. One supervisor would be required per thana. Major tasks of supervisors would include: assistance in purchasing of goats as credit-in-kind, provision of basic veterinary services, and supervision of end use and repayments. Supervisors should have knowledge of livestock; short basic training would be provided by the District Livestock Officer.

4.52 Fish Ponds. About four thanas would be selected for the development of fish ponds. In year 1, about 40 villages in two TCCA would be covered with roughly 15 ponds per village. Ponds selected would be small and without need of excavation; most would be privately owned with a limited number of shareholders. According to IRDP's initial survey, Comilla and Barisal both hold sizeable concentrations of ponds which would meet the above criteria. These districts are covered by the IDA Fisheries Project, providing the necessary fish fry and backup technical services. An estimated Tk 2,000 would be required per one acre pond to purchase fish fry and feed, construct bamboo protection, and clear hyacinths. Sales would increase gradually to about Tk 20,000 annually by year 3 for a one acre tank. With roughly 15 ponds each in 40 villages, the project would yield about 15,000 fish per village per year or about 50 per day, which could be absorbed by the local market. Credit totalling roughly Tk 2.4 million would be required for 1,800 ponds over three years; full repayments could be scheduled for three years. One

supervisor would be required per TCCA. Cooperation would be needed from thana and district fisheries officers to train the supervisors and cooperators; arrangements would need to be made with BADC to assure feed availability. Prior to implementing this project element, IRDP Rural Industries staff needs to select TCCA with strong management, concentration of fish ponds not requiring excavation, and reasonable access to subdivisinal headquarters.

4.53 Poultry. About 10 TCCA would be selected for development of small scale chicken raising. In each thana, 10 villages with reasonable access to headquarters would be involved with about 20 members per cooperative. In year 1, each member would borrow for about 10 traditional or improved scavenger chickens, which is considered a reasonable number without requiring feed. With 10 villages per TCCA, 100 villages and about 2,000 cooperators could be involved in year 1. With average credit requirements of Tk 200 per cooperator, at least Tk 1,000,000 would be required over a three year period. One year maturities with monthly installments would be appropriate. Annual earnings of Tk 550 for one layer can be expected with a 10% death rate. The most critical input to successful poultry raising is the availability of vaccines, which require refrigeration. Only those thanas with electricity and with a relatively small loadshedding problem would be incorporated; special arrangements would be made to assure availability of vaccines. One supervisor working on both poultry and goats would be assigned to each thana; training from the Livestock Directorate would be arranged.

4.54 Next Steps. Prior to disbursements for this component, IRDP would undertake the following actions: (a) establish an effective headquarters organization for rural enterprise development, recruiting at least three rural enterprise specialists and one staff member to design and install a monitoring and evaluation system as well as a consultant to assist in implementation and monitoring during year 1, in a manner satisfactory to IDA; (b) select thanas, and eligible activities 1/ and (c) prepare an action plan for year 1 of the project, with immediate implementation of schemes in the women's areas and organization, training and preparation of loan applications for landless cooperatives in year 1. Each January 1, IRDP would begin implementation of an annual action plan which had been furnished to IDA taking into account IDA's comments. Under these guidelines, the credit and technical services under the rural enterprise component are expected to benefit a target group of up to about 10,000 rural families, the majority of which would be landless or marginal farmers. It is anticipated that detailed institutional analysis of IRDP would be done in preparation for the second rural development project. Findings of this study combined with experience under SSI III should provide a good base for further IDA assistance in rural enterprise development.

1/ A tentative list of 10-15 Thanas has been discussed between IDA and GOB/IRDP. An agreed final list of thanas to be covered during the three year implementation period would be included within IRDP's year 1 action plan. Thanas would be selected according to (a) classification as Category "A" TCCA; (b) existence of ecological conditions appropriate for the agro-related activities selected; (c) considerable tradition in the activities to be undertaken; and (d) a high concentration of landless and marginal farmers.

5. Study of Rural Enterprise Development

4.55 SSI III would help finance consultancy for a study by the Planning Commission on potential in and needed institutional services for rural enterprise development. Emphasis would be given to identifying promising new and existing rural enterprises which: process agricultural products; provide manufactured goods and repair services for local markets; or make ancillary parts for other industries. Industries selected for detailed project development would be: agro-related, labor-intensive, have short gestation periods, and lend themselves to widespread application.

4.56 The Planning Commission would conduct detailed studies in about 35 thanas, beginning with 10 in year 1. Since many thanas lend themselves to similar industries, several project profiles and assistance models developed for the first 10 thanas should have application in the other thanas. The aims of the study will be to: formulate area development plans for promotion of rural industries in each of the thanas under study; identify feasible rural industries and recommend measures for development of these industries; determine relative economic benefits of alternative processing technologies; and prepare project profiles, manufacturing guides and technical service packages for identified subprojects. The study would make use of available research on rural enterprises but would give greater attention than in past studies to: (a) identifying enterprises which can provide goods and services at competitive prices; (b) assessing local market potential for expanded production in existing and new lines; (c) comparing economic benefits of alternative production technologies, particularly in agro-processing lines; (d) moving quickly to development of concrete project profiles and manufacturing guides to serve as promotional tools; and (e) assessing existing and needed policy, and private and public institutional support.

4.57 The study would be implemented over a three-year period. However, phasing would be such that some area schemes, profiles and guides will be available after year 1. After 18 months the study team would prepare an interim report with recommendations on public and private institutional services needed to accelerate development of viable rural enterprises. The study is expected to provide a basis for GOB's rural enterprise strategy. Estimated costs of the study, which would be incorporated as a component of SSI III, would be about US\$0.8 million equivalent of which IDA would finance about US\$0.4 million in foreign exchange for consultants. GOB would need to provide financing for local currency requirements. The Planning Commission and IDA would agree on terms of reference and selection of the consultants for the proposed study. The Planning Commission's draft proposal for the study was discussed in substance during negotiations.

V. THE PROPOSED CREDIT

5.01 Lending Arrangements. The proposed credit of SDR 26.7 million (\$35 million equivalent), consisting of a \$30 million subloan component and a \$5 million technical service component, would be made to the Government of Bangladesh. The credit is expected to be committed in about three years and disbursed in about 3.5 years from the date of credit effectiveness. Annex 2, Table 7

shows the estimated schedule of disbursements. For the subloan component, Bangladesh Bank would act on behalf of GOB, maintaining accounts to channel IDA disbursements of Bangladesh Bank's refinancing of SCI subloans made by participating banks, initially involving three commercial banks and BSB. GOB would bear the foreign exchange risk on repayments to IDA. Repayment by Bangladesh Bank to GOB would be on a fixed amortization schedule. The technical service component would cover specific items of training, advisory services and equipment for the participating agencies. The SCI Unit of Bangladesh Bank would be responsible for the portion of the technical service component allocated for the participating credit institutions. The other elements of the technical service component would be the responsibility of the respective implementing agencies; each would have separate action plans. Expenditures under the technical assistance component would not be repayable to GOB.

5.02 Onlending Terms. The participating credit institutions would charge a standard interest rate of not less than 13% per annum to SCI subborrowers. Interest rate and spread arrangements are summarized in the table of para 4.18. The participating credit institutions would maintain spreads of at least 4%-8%. Bangladesh Bank would retain a minimum spread of 2% ^{1/} to cover administrative and financial carrying costs. No commitment fee would be charged on the subloan component as in Credit 353-BD (SSI I) and Credit 825-BD (SSI II). The waiver is proposed again due to the multiple institutions involved and the small scale nature of subborrowers.

5.03 SCI Fund. Bangladesh Bank would make available funds out of its Industrial Development Fund (Tk 75.0 million as of June 30, 1979) to cover initial operating costs of the SCI Refinance Unit as well as the time lag between Bangladesh Bank's refinance of SCI subloans and its withdrawals from IDA. Annual appropriations would continue to be made as needed.

5.04 Subloan Sizes and IDA Review. Based on the experience under Credit 825-BD and the expected increase in smaller subloans, about 1,200 sub-projects ^{2/} are expected to receive financing under the proposed credit. In view of the large number and relatively small sizes of subloans, simplified review and approval procedures would be used to keep administrative costs and processing times within reasonable bounds. On refinancing smaller subloans, Bangladesh Bank's SCI Refinance Unit would do a rapid review to check the eligibility of the subproject, its financial viability and the adequacy of proposed subloan terms. Periodically, the SCI Unit would undertake sample analyses of appraisal reports submitted for the smaller approved subloans to check that appropriate appraisal standards are being maintained. For subloans of Tk 500,001 to Tk 1,500,000, detailed review and approval by the SCI Unit would be required prior to submitting withdrawal applications to IDA. Bangladesh Bank would certify to IDA that subprojects meet eligibility criteria, are financially viable and that subloan terms are appropriate. For subloans above Tk 1,500,000, IDA's prior review and approval would be required. It is expected that subloans of above Tk 500,000 will account for about 10%

^{1/} 1% in case of subloans channelled through the participating TCCA.

^{2/} Including loans to cooperatives through the participating TCCA.

of total subprojects by number and 40% by amount. IDA would fully review and approve only a small number of subprojects; however, samples of appraisal reports and review memoranda of Bangladesh Bank would be sent to IDA for subloans of up to Tk 1,500,000 to ensure that appraisal standards are maintained.

5.05 Disbursement. All subloan disbursements for foreign or local expenditures would be eligible for refinancing by Bangladesh Bank for up to 100% of the total subloan amount. IDA would disburse 100% of the subloan amounts refinanced by the SCI Unit. IDA financing would cover about 70% of total subproject costs. The average foreign exchange content of subprojects is estimated to be about 50%. Withdrawal applications would be submitted to IDA by Bangladesh Bank. In view of the large number of subprojects involved and the small subloan sizes, the normal DFC procedure of disbursing against expenditures on individual subproject accounts would be inappropriate. Thus, all disbursements for foreign or local expenditures made by the commercial banks will be financed equally up to 70% of subproject costs. ^{1/} Disbursements for subloans above Tk 500,000, accounting for about 40% by amount of the project's subloan component, would be fully documented, except for permanent working capital. Disbursements for permanent working capital and for the balance of subprojects would be reimbursed against statements of expenditure, certified by the credit institutions, showing their own subloan disbursements for the specific subprojects; IDA's reimbursements to Bangladesh Bank would be limited to expenditures made by the sub-borrower not more than 120 days prior to IDA's receipt of Bangladesh Bank's request for reimbursement; exception would be made to disbursements on expenditures qualified under the proposed retroactive financing (para 5.09). Statements of expenditure, together with supporting documentation, would be audited at least annually. In the case of the technical service component, IDA would disburse (a) 100% of foreign expenditures for equipment imported directly and for locally manufactured equipment purchased ex-factory; (b) 80% of expenditures for other equipment procured locally; (c) 100% of total expenditures for consultant's services and overseas training; and (d) up to 90% of expenditures for sales and exposure trips for exporters. For the amounts allocated for preidentified items, withdrawal applications would be submitted directly to IDA by the implementing agency. Authorization by IDA for financing of goods and services under the technical service component would be required; requests for disbursement by IDA would be fully documented.

5.06 Procurement. Contracts of goods and services procured outside of Bangladesh costing US\$6,000 equivalent or more per item or \$30,000 per contract shall be let through international shopping on the basis of at least three (3) competitive quotations and shall be used exclusively for carrying out the investment project; for contracts of goods and services costing less than US\$6,000 equivalent, the participating banks would ensure and certify that these are reasonably priced and are suitable to the requirements of the investment project. This is in line with procurement procedures under Credit 825-BD and is appropriate for SCI operations. Participating credit institutions would be required to maintain records of the method of procurement. Staff of

^{1/} Up to 80% in case of subloans below Tk 500,000.

the SCI Unit and IDA's supervision mission would do periodic reviews of these procedures.

5.07 Repayment Schedule to GOB. The maximum maturity for subloans refinanced by Bangladesh Bank would be 12 years including a grace period of up to three years. Repayments to Bangladesh Bank would be on the basis of a composite schedule composed of the sum of amortized schedules of individual subloans. Repayments by Bangladesh Bank to GOB would be on a fixed amortization schedule payable up to 15 years including a grace period of five years.

5.08 Reporting, Accounts and Auditing. The SCI Unit of Bangladesh Bank would submit quarterly reports on its activities to IDA. The main report would be an aggregation of the individual quarterly reports by participating credit institutions covering activity, portfolio data, collection and arrears performance and supervision results. In addition, the SCI Unit would submit a quarterly statement of its own activity in refinance and details of disbursements. Both sets of reports would have a content and format acceptable to IDA. In addition, the SCI Unit would prepare annual reports on the performance of the participating institutions under the proposed credit. These reports would consolidate and present an analysis of the quarterly reports including a projection of commitments, refinance, and withdrawals from IDA; the SCI Unit also would present its assessment on the standards and procedures of the participating institutions and propose actions for improvement including training program; the report should include the audited annual reports of Bangladesh Bank and the participating institutions and should be submitted within six months after the end of the fiscal year of the commercial banks. Each credit institution would maintain accounts for subloans and documentation on disbursements and procurement procedures for all subloans; these accounts would be audited annually. Each technical service agency would be expected to prepare annual implementation programs and quarterly progress reports, which would be submitted to the National Small Industry Council ^{1/} and to IDA. Separate accounts, audited annually, would be maintained by the implementing agencies for the technical service elements.

5.09 Bridge and Retroactive Financing. Full commitment by the banks of the subloan component of Credit 825-BD was achieved by June 30, 1980. Janata and Sonali have about US\$4.5 million in the pipeline; to enable Janata and Sonali to continue sanctioning and disbursing against SCI subloans, GOB would need to make bridge financing arrangements, allocating cash foreign exchange as a temporary source of funds for Janata's and Sonali's SCI subloans. To enable continued commitments until credit effectiveness of SSI III, GOB has allocated cash foreign exchange. Disbursements for subprojects meeting established criteria would be eligible for retroactive financing under SSI III. The proposed SSI III Credit is likely to be signed in October 1980.

^{1/} GOB intends to establish a National Small Industry Council to review and expedite project implementation and ensure that necessary Government funds would be made available for the project. Key officials of the implementing agencies, the involved ministries and the Planning Commission would be appointed to the SCI subcommittee of the Council.

The gap to be covered would be from about July to the date of credit signing. As of February 29, 1980, subloans totalling US\$450,000 equivalent have been sanctioned by Janata and Sonali 1/; the banks estimate that about 60% of this would be disbursed by September 1980. With the actual monthly average approval of US\$600,000, Sonali and Janata would be expected to have additional commitments of US\$3.6 million to be financed out of SSI III by September 1980; disbursements are expected to be US\$900,000 during the same period. Accordingly, US\$1 million equivalent in retroactive financing would be appropriate. In processing subprojects prior to credit effectiveness, Janata and Sonali would appraise and approve subprojects submitting them to IDA through Bangladesh Bank. Authorization procedures used under Credit 825-BD would be employed for subprojects eligible for retroactive financing under SSI III. Screening and approval by the review committee, however, would not be required. Once GOB, Bangladesh Bank and IDA have agreed that the SCI Refinance Unit is duly established within Bangladesh Bank, subproject review procedures would be decentralized, as outlined in para 4.11. Subloans submitted to IDA prior to effectiveness of SSI III should be on terms and conditions agreed under SSI III; a detailed schedule of disbursements by the banks should be provided.

VI. PROJECT BENEFITS AND RISKS

Benefits

6.01 The proposed project would address major constraints hindering more rapid growth and productivity improvement in SCIs. Access to term credit would be increased for a wide range of manufacturing and industrial service enterprises. The IDA Credit would fill a significant portion of the gap in resources available for SCI lending. It is anticipated that about 1,200 subprojects would be financed, with costs including sponsor's equity totalling Tk 665 million (US\$42.9 million). Differential spreads according to the size of the subloan would be provided to the banks to induce them to give increased attention to smaller customers. It is expected that about 60% of the amount of the subloan component would be for loans below Tk 500,000. Direct employment generated is projected to be about 14,000 full time jobs for organized SSI and transport subloans, with fixed costs per job averaging about US\$2,000. Credit and technical services under the rural enterprise component would be provided according to agreed eligibility criteria which are designed to benefit a target group of up to 10,000 rural families, the majority of which would be landless or marginal farmers. Credit, marketing and consulting services to exporters could result in increased sales and earnings for as many as 8,000 households engaged in handicrafts, which fall within participating exporters' production networks. In handicrafts and rural enterprises, fixed costs per job normally would fall well below Tk 7,750 (US\$500).

1/ These subloans are for subprojects with fixed costs over Tk 1 million each for which allocations under Credit 825-BD already have been exhausted. Full disbursements are projected to take place within 10 months of approval; this is consistent with experience under Credit 825-BD. The rate of disbursement should improve with the banks' growing experience in subloan disbursement and project implementation.

6.02 The marketing and technical service components are expected to have a significant impact on growth and productivity of SCIs in priority subsectors. BSCIC's subcontracting exchange, subsector programs, pilot projects and general promotion and extension services could cover roughly 2,000 firms over the three year implementation period. The Export and Product Development Program probably would provide consultancy services and trips to over 100 exporters, who in turn could organize production and sales from some 8,000 decentralized SCI producers. The common facilities and technical services in leather would cover about 200 tanneries and yield increased foreign exchange earnings. Monitoring and reporting systems have been designed to measure coverage of these technical and marketing programs and provide indicators of their impact on employment, earnings, output and productivity in the targeted SCI segments.

6.03 The substantial size of the project and its components are geared to build capabilities of credit and technical service institutions dealing with SCIs. Arrangements for SCI lending operations would be clear, with the participating banks fully responsible for appraisal, loan processing, supervision and collections. The network of credit institutions with capabilities in SCI term lending would be expanded to include Agrani and BSB as well as Janata and Sonali Banks. Training, differential spreads, and the credit guarantee should help increase the banks' ability and willingness to make smaller project-based loans, particularly from the branches. Through the SCI Refinance Unit, Bangladesh Bank would build an organization with review capabilities to serve as a uniform channel for GOB, IDA and other outside funding of SCI lending requirements. Under the technical and marketing service component, BSCIC's organization, staffing and programs for SSI promotion and technical services would be strengthened, particularly in the districts. The EPB Program would give this organization the means to take a more active role in export promotion and supply development. The capabilities of IRDP and selected TCCA to promote selected agro-related rural enterprises would be strengthened, with a view to more sizeable involvement in the future. The EPB Program, the leather services, and the pilot projects are structured to tap managerial and technical skills of private exporters and manufacturers in helping meet SCI development objectives.

Risks

6.04 Several project elements represent new or significantly expanded activities for the implementing agencies. While Bangladesh Bank has sizeable refinancing operations, the SCI Refinance Unit would represent the first formal SCI subproject review and refinance operations. However, Bangladesh Bank staff have chaired the bi-monthly meetings of the review committee for SSI II and subproject review capabilities would be bolstered through outside training and consultancy during the first year of operations (para 4.09). SSI III involves a sizeable expansion of export promotion and supply development activities by EPB, although this organization has established a successful track record during the last three years (para 4.45), and is judged capable of implementing the proposed component. The rural enterprise component is designed to minimize the burden on IRDP; however, risks exist that the critical organization, training and monitoring functions would not be performed according to the implementation plan and that the selected TCCA would not serve as effective mechanisms for channelling technical and credit services to rural

enterprises composed mainly of landless. Consultancy services, clear eligibility criteria and frequent supervision would be maintained to help ensure successful implementation of this element (paras 4.47-4.54). Finally, there are risks that BSCIC, still a weak institution, would not take the necessary steps to improve its organization, staff and programs; however, this would not impair the chances for successful implementation of the other project components. Para 4.32 outlines what are considered necessary steps to ensure effective implementation of the portion of the project to be implemented by BSCIC; these steps would need to be taken by January 31, 1981. GOB has stated commitment to making these changes in BSCIC.

VII. RECOMMENDATIONS

7.01 During negotiations, agreement was reached between IDA and the Government of Bangladesh on:

- (a) GOB's budgetary allocations to cover incremental costs for staff, overheads, land and buildings for the technical service component over the three year commitment period (para 4.05);
- (b) institutional responsibilities and mechanisms for coordination and monitoring (paras 4.07);
- (c) onlending terms, conditions, margins, eligibility criteria, allocations, and refinance arrangements for subloan component (paras 4.13-4.19);
- (d) administrative arrangements, terms of reference and financing of advisors and consultants (paras 4.28-4.57);
- (e) implementation plan for the credit and annual action plans for technical service component (paras 4.29-4.57);
- (f) steps to be taken on staffing, training, and incentives for extension staff of BSCIC at headquarters and in the district offices by January 31, 1981 (para 4.32);
- (g) establishment of an EPB Fund with policies, operating procedures, and Year 1 action program by January 31, 1981 (para 4.46); and
- (h) bridge and retroactive financing requirements (para 5.09).

7.02 It is recommended that the following conditions be met prior to credit effectiveness:

- (a) establishment of the SCI Refinance Unit in Bangladesh Bank, including Bangladesh Bank approval of a statement of policies and operating procedures satisfactory to IDA, recruitment and training of agreed minimum staff (paras 4.08-4.12);

- (b) incorporation by Bangladesh Bank of agreed modifications in the SCI Credit Guarantee Scheme (para 4.20);
- (c) signing of participation agreements, satisfactory to IDA, between Bangladesh Bank and at least two credit institutions (para 4.22); and
- (d) signing of a subsidiary loan agreement, satisfactory to IDA, between GOB and Bangladesh Bank.

7.04 Conditions of disbursement from the IDA Credit would be made on the following technical service components:

- (a) establishment under the Institute of Leather Technology of a program to provide common facilities and services to private tanneries with staffing and year 1 action plan satisfactory to IDA (para 4.42); and
- (b) adoption of year 1 action plan for IRDP and appointment of consultant and staff required for project implementation, satisfactory to IDA (para 4.54).

BANGLADESH

PROFILES OF SUBPROJECTS FINANCED UNDER
CREDITS 353-BD AND 825-BD

1. SSI I. Under Credit 353-BD, thirty-eight subprojects were financed; about 80% of these were textiles and grain milling; most were significantly more capital and import intensive than other small industries; and nearly 90% of the subloans were in the three major urban centers. Repayment performance has been weak until recently, when the banks have increased attention to follow-up and collections. As of February 28, 1980, arrears represented 35% of amounts due vs. 61% as of June 30, 1978. Detailed descriptions of subprojects financed under Credit-353-BD are provided in the Project Completion Report of May 1979.

2. SSI II. As of February 29, 1980, 129 subprojects had been approved by the participating banks under Credit 825-BD. Forty of approved amounts and 60% of subprojects are outside Dacca, Chittagong and Khulna. The average subloan size has been Tk 600,000 (US\$38,700) ranging from Tk 35,000 (US\$2,300) to Tk 3.2 million (US\$206,500). While it is too early to judge actual performance, in accordance with the eligibility criteria, appraisal reports for these subprojects indicate that most are based upon a high utilization of indigenous or locally fabricated inputs; an average of 87% of the value of raw materials is estimated to be of local origin, which is significantly higher than the minimum of 60% required under Credit 825-BD. Most subprojects involve agro-processing (35%), light engineering (19%), or provide inputs into the agriculture or fishing sectors. A wide diversity of product and industrial service groups have been financed. Approved subprojects average about US\$2,000 ^{1/} in incremental fixed costs per job generated, which is 33% lower than the maximum ratio required under Credit 825-BD. The range has been US\$350 to US\$3,000 in fixed costs per job. For subprojects with loans above Tk 100,000, the financial rates of return (ex ante) are between 15% to over 50%; the average rate of return is about 30%. Tables describing characteristics of these subprojects are in the project files.

^{1/} The average fixed costs per job of subloans above Tk 100,000 has been US\$2,400 (Tk 36,700); the average of subloans of up to Tk 100,000 has been about US\$900 (Tk 14,000).

3. Project selection criteria and increased decentralization in appraisal responsibility appear to have resulted in selection of subprojects of greater diversity and higher economic merit under Credit 825-BD compared to Credit 353-BD. Approved subprojects as they appear in the appraisal reports are compared in the following table:

<u>Profile</u>	<u>SSI I</u>	<u>SSI II</u> (As of Feb. 28, 1980)
(a) number of subprojects	38	129
(b) subloan amounts (Tk million)	31.4	83.2
(c) average subloan size (Tk 000)	826	645
(d) fixed cost per job (Tk 000) <u>/a</u>	40	31
(e) average percentage of local raw materials to total	49	87
(f) percentage of subprojects outside Dacca, Chittagong, and Khulna	11	60
 <u>Percentage of Subprojects in</u>		
(a) food and allied <u>/b</u>	34	35
(b) textiles, garments	42	5
(c) engineering	8	19
(d) printing	8	5
(e) ice plants for fishing	-	15
(f) chemical industries <u>/c</u>	-	12
(g) others	5	9

/a SSI I had fixed costs per job of as high as Tk 80,000, while for SSI II, the maximum is Tk 45,000.

/b While, under Credit 353-BD, oil and flour mills represented 85% of agro-based subprojects, in Credit 825-BD these groups have constituted 31% with subprojects also in rice, seafood freezing, sugar and poultry.

/c E.g., ink, starch, plaster of paris, pharmaceuticals.

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Geographical Distribution of Small-Scale Industries
(in thousands of takas)

District	Number of Units	Total Investment	Plant and Machinery	No. of Persons Employed		Wages and Salaries		Raw Materials and Spare Parts	Electricity and Fuels	Net Receipts	Gross Output	Value Added
				Total Employees	Production Workers	Total Employees	Production Workers					
Chittagong	2,890	144,950,187	90,685,316	15,066	10,674	52,656,756	36,180,505	293,243,744	38,339,465	120,781,466	349,817,173	139,007,430
Chittagong Hill Tracts	223	7,410,185	3,846,837	1,649	1,238	4,576,995	3,271,133	11,204,349	1,884,724	6,176,141	12,970,577	6,357,061
Noakhali	1,136	82,718,025	40,279,160	5,706	3,396	21,502,520	14,346,420	113,372,585	20,651,261	69,554,710	145,255,791	75,786,447
Sylhet	1,262	75,737,362	34,092,757	8,097	5,339	29,969,983	20,037,641	78,432,106	15,216,374	66,592,693	100,848,109	74,010,891
Dacca	6,444	645,559,924	356,022,764	43,636	32,075	181,174,885	131,710,226	900,115,835	90,365,266	318,087,894	1,263,639,535	591,246,328
Comilla	1,556	137,898,335	56,630,950	7,841	6,119	32,999,712	26,395,230	345,196,197	22,151,096	60,477,744	448,684,718	136,815,169
Rajshahi	1,122	85,215,927	42,643,500	9,988	6,323	20,094,880	10,734,540	128,240,994	18,103,989	72,075,750	165,167,001	89,097,774
Bogra	484	41,150,517	19,408,964	9,119	1,857	10,653,012	7,109,904	32,732,688	6,851,072	31,005,574	48,559,037	30,064,851
Faridpur	1,032	54,757,491	30,600,717	3,695	2,594	11,495,517	7,955,680	31,745,910	10,490,711	69,489,870	21,483,022	48,736,271
Mymensing	845	40,931,460	21,281,363	3,467	2,463	12,548,748	8,654,664	19,932,241	9,384,885	40,387,821	23,529,910	34,520,603
Tangail	349	14,946,338	7,882,874	2,884	2,437	6,739,759	5,196,049	19,996,717	3,928,611	11,750,700	25,995,240	13,825,612
Khulna	1,703	146,717,202	67,268,433	11,261	7,816	41,564,653	9,214,256	88,112,813	27,280,850	127,282,840	117,244,532	129,133,709
Kushfia	403	28,805,913	15,654,013	1,636	1,122	5,897,982	4,072,920	13,451,980	5,034,392	26,854,096	17,730,171	26,097,895
Barisal	1,062	62,481,647	36,601,594	8,277	4,726	29,986,647	16,594,096	217,503,467	21,255,982	40,448,828	265,706,055	67,395,434
Jessore	920	94,537,264	35,200,973	4,427	3,153	14,182,060	9,938,500	129,967,964	14,231,679	43,490,436	190,573,281	89,864,074
Patuakhali	320	17,894,501	7,946,447	2,872	1,560	9,501,700	5,615,500	73,266,936	4,051,069	4,228,000	88,698,503	15,608,498
Dinajpur	638	44,150,028	22,781,493	6,788	4,197	22,215,117	13,222,207	111,462,338	8,789,732	39,400,000	130,433,221	49,581,151
Pabna	1,457	96,169,173	60,981,327	23,559	12,183	70,177,857	34,391,392	352,880,645	7,650,574	38,798,178	451,341,068	129,608,027
Rangpur	833	60,167,259	32,876,412	5,473	3,242	19,166,468	12,011,730	197,679,543	7,745,602	36,483,933	236,466,847	42,258,345
Jamalpur	329	13,973,948	6,140,769	1,902	1,413	6,488,807	4,505,522	30,350,707	4,604,529	12,567,683	33,397,109	11,009,356
GRAND TOTAL	25,032	1,897,708,746	989,939,963	177,459	114,543	544,079,438	381,616,302	3,189,710,149	338,249,351	1,230,667,297	4,340,162,212	1,801,329,492

Source: 1978/79 Survey of Small Industries conducted by the Bangladesh Small and Cottage Industries Corporation.

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Distribution of Small-Scale Industries by Subsectors^{1/}
(in thousands of takas)

<u>Industrial Subsector</u>	<u>Number of Units</u>	<u>Total Investment</u>	<u>Plant and Machinery</u>	<u>No. of Persons Employed</u>		<u>Wages and Salaries</u>		<u>Raw Materials and Spare Parts</u>	<u>Electricity and Fuels</u>	<u>Net Receipts</u>	<u>Gross Output</u>	<u>Value Added</u>
				<u>Total Employees</u>	<u>Production Workers</u>	<u>All Employees</u>	<u>Production Workers</u>					
Food and allied products	17,356	1,192,331	564,886	95,008	65,241	328,413	219,129	1,805,721	238,042	958,886	2,255,506	1,155,591
Textile, weaving apparel and leather	2,442	178,689	90,925	32,459	18,145	106,855	61,121	611,406	14,795	24,392	769,852	168,178
Wood and wood products including furniture	920	83,785	42,879	7,205	5,029	40,611	21,520	92,585	12,010	47,896	134,654	79,949
Paper and paper products, printing and publishing	1,111	147,654	104,879	7,649	5,439	32,150	22,577	115,863	7,844	68,794	203,905	140,290
Chemicals, petroleum, coal, rubber and plastic products	526	67,341	30,929	5,796	3,767	25,105	16,505	202,686	10,824	12,004	265,328	63,881
Non-metallic mineral products, except products of petroleum and coal	216	23,153	8,716	8,092	6,878	21,886	17,158	50,854	27,635	965	111,237	33,708
Basic metal industries	1,719	157,616	112,385	10,970	7,934	47,500	34,848	166,901	17,195	108,097	223,485	139,208
Fabricated metal products, machinery and equipment	657	51,209	35,779	4,566	3,536	18,407	13,591	136,117	10,986	31,284	165,322	49,402
Other manufacturing	137	55,003	1,398	476	321	1,538	1,061	7,438	739	952	9,576	2,348
<u>GRAND TOTAL</u>	<u>25,084</u>	<u>1,956,781</u>	<u>992,776</u>	<u>172,221</u>	<u>116,290</u>	<u>622,462</u>	<u>407,510</u>	<u>3,189,571</u>	<u>340,070</u>	<u>1,253,270</u>	<u>4,138,865</u>	<u>1,832,555</u>

Source: 1978/79 Survey of Small Industries conducted by the Bangladesh Small and Cottage Industries Corporation.

^{1/} This survey includes industries with fixed investment including land of up to Tk 2.5 million.

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INDICATORS OF PERFORMANCE IN LARGE AND SMALL SCALE INDUSTRIES

Industrial Subsector	Share of % of Total ^{1/}			Ratio in Takas	
	Value Added	Fixed Investment	Employment	Fixed Investment per Employee	Value Added per Unit of Labor & Capital Cost ^{2/}
<u>Food and Allied Products</u>	66	35	35	9.400	26.10
Large	60	19	13	14.101	14.76
Small	6	16	22	6.700	47.00
<u>Textile, Weaving Apparel and Leather</u>	9	17	31	5.219	6.30
Large	4	11	9	11.973	4.10
Small	5	6	22	2.472	9.50
<u>Wood and Wood Products Including Furniture</u>	2	2	6	3.529	1.00
Large	-	-	-	-	-
Small	2	2	6	3.529	1.00
<u>Paper and Paper Products, Printing and Publishing</u>	20	18	4	16.063	1.20
Large	13	16	2	21.930	1.40
Small	7	2	2	5.483	1.10
<u>Chemicals, Petroleum, Coal, Rubber and Plastic Products</u>	15	14	16	8.169	11.90
Large	8	8	9	7.970	10.90
Small	7	6	7	8.424	14.20
<u>Non-metallic Mineral Products, Except Products of Petroleum and Coal</u>	7	3	2	10.665	2.00
Large	6	2	-	14.803	1.80
Small	1	1	2	8.001	2.30
<u>Basic Metal Industries</u>	16	5	4	11.034	2.70
Large	8	3	1	22.012	4.90
Small	8	2	3	6.352	1.40
<u>Fabricated Metal Products, Machinery and Equipment</u>	4	4	9	3.759	2.90
Large	-	-	-	-	-
Small	4	4	9	3.759	2.90
<u>Other Manufacturing</u>	11	4	2	20.028	1.50
Large	2	3	-	34.920	3.00
Small	9	1	2	7.978	0.90
<u>Total</u>	100	100	100	9.344	14.80
Large	76	61	23	17.407	9.30
Small	24	39	67	5.407	36.00

^{1/} Figures do not add to 100 due to rounding.

^{2/} Assuming capital cost of 15%.

^{3/} Excluding tobacco and cigarettes.

Source: 1974 Manufacturing Census conducted by the Bureau of Statistics, Ministry of Industries.

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Demand for Credit by Small-Scale and Cottage Industries (SCIs)
at 1978/79 Prices

(in millions of takas)

	GDP at factor cost	Industrial GDP at factor cost	Share of registered small industries in industrial GDI ^{1/}	Value added of unregistered and cottage industries ^{2/}	Total value added SCIs
1978/79	136,632	10,317	4,127	2,682	6,809
Estimated growth rate 1979/80 ^{3/}	3%	4.5%	6%	6%	6%
1979/80	140,731	10,781	4,375	2,842	7,218
Projected average growth rate 1980/81-1981/82 ^{4/}	5%	5.5%	7.5%	7.5%	7.5%
1981/82	155,156	11,999	5,056	3,284	8,340
Incremental value 1979/80-1981/82	14,425	1,218	681	442	1,123
Assumed ICOR ^{5/}		3.0	2.0	0.5	1.25
Total fixed investment		3,654	1,362	221	1,583
Assumed fixed investment/permanent working capital ratio ^{6/}			1	1	1
Permanent working capital			1,362	221	1,583
Total investment			2,724	442	3,166
Credit financing ^{7/}			0.33%	0.25%	0.29%
Credit demand			899	111	
Credit demand in millions of US\$ ^{8/}			58.0	7.2	65.2
Assumed cumulative world inflation rate for the period 1979/80-1981/82			17%	17%	17%
Credit demand in millions of US\$ in current prices			67.7	8.4	76.3

- ^{1/} National accounts data show that the share of small-scale industries in industrial GDP corresponds to 40%. This does not include unregistered and cottage industries. The same share has been assumed for the period 1980/81-1981/82.
- ^{2/} Extrapolating from the latest available cottage industry census (sample 61,000 firms), the value added of this sector has been estimated at an additional 25% of the present industrial GDP, i.e. some 65% of the value added of small-scale industries. This share is assumed to remain constant over the next years.
- ^{3/} Corresponds to latest estimates by the Bangladesh Bank and World Bank staff and is based on actual figures for the first half of that fiscal year.
- ^{4/} Growth rates projected by the Bangladesh Paanning Commission for the Second Five-Year Plan are higher. These growth rates are based on the assumption that only part of the Development Plan will actually be implemented.
- ^{5/} No consistent and well-founded calculation of ICORs for Bangladesh exist, mainly due to poor statistical data. Attempts of such calculations show ICOR values of 2.7-3.5 for industry. Since small-scale industries are less capital intensive than large ones, the ICOR has conservatively been assumed at 2.0. Similar ICORs have been calculated for other countries in the region. For cottage industries, the ICOR is likely to be much lower.
- ^{6/} Although the statistical basis available indicates significantly higher ratios, this conservative assumption has been adopted due to the usually heavily depreciated book value of fixed assets. It coincides with analysis conducted by BSB and by the commercial banks.
- ^{7/} The assumptions for the share of credit financing in total investment requirements have been noted in Chapter II, para. _____. The share for cottage industries, which generally have even less access to credit, has been assumed to be even smaller.
- ^{8/} Assuming a constant exchange rate of Tk 15.5/US\$1.00.

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Interest Rate Structure

	<u>Percent</u>
A. <u>Bank Rate</u>	
General	8.0
Bangladesh Krishi Bank (BKB) and Bangladesh Samabaya Bank	6.0
B. <u>Deposit Rates</u>	
Special notice deposits	4.0-4.25
Savings deposits (with checking facility)	4.5
Savings deposits (without checking facility)	7.0 <u>1/</u>
Fixed deposits (3-6 months)	7.0 <u>2/</u>
Fixed deposits (6-12 months)	7.5 <u>2/</u>
Fixed deposits (1-2 years)	8.25 <u>2/</u>
Fixed deposits (2-3 years)	9.25
Fixed deposits (3 years and over)	10.25 <u>3/</u>
Post savings deposits	8.5-11.25
C. <u>Lending Rates</u>	
Commercial bank short-term loans	11.0-12.0
Jute trade, jute goods and tea	10.5
Other export commodities	10.5
Industrial loans (BSB and BSRS) <u>4/5/</u>	
Domestic currency loans	11.5
Foreign currency loans	11.5-12.5 <u>6/</u>
Agricultural loans	
Short-term loans for tea and jute	10.5
Short-term loans for potato storage	12.5
Other short-term loans	11.0
Medium- and long-term loans	11.5
Long-term loans for shallow tubewells	13.0
Long-term loans for tea development	9.0
Horticulture development in Chittagong H.T.	5.0
Primary societies loans <u>7/</u>	12.0
Construction loans (multi-dwelling units) <u>8/</u>	5.0
Construction loans (single dwelling units) <u>8/</u>	11.0

Source: Information supplied to the Third SSI appraisal mission by commercial banks, BSB and Bangladesh Bank.

- 1/ Since October 1, 1978, interest on accounts opened by individuals in rural areas is 7.75%.
- 2/ Since October 1, 1978, interest on accounts opened by individuals in rural areas is 1-1.5 percentage points higher than in urban areas.
- 3/ BSB, BSRS and BKB can give 1 percentage point more on fixed-term deposits than commercial banks.
- 4/ Bangladesh Shilpa Bank and Bangladesh Shilpa Rin Sangstha Bank.
- 5/ The lending rate should be 3.5% above the Bank rate, subject to a minimum of 11.5%.
- 6/ Onlending of foreign aid funds is in accordance with the terms of the respective aid agreements.
- 7/ Primary societies borrow from central cooperative banks at 9% which borrow from the Bangladesh Samabaya Bank (Appex Cooperative Bank) at 7%.
- 8/ Loans by the Bangladesh House Building Finance Corporation.

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THIRD SMALL SCALE INDUSTRIES PROJECT

Table of Estimated Project Costs

Component	(US \$ million equivalent)		GOB/ Implementing Agency	Private Sponsor	Total
	IDA (Foreign Currency)	IDA (Local Currency)			
I. Subloan Component	17.20	12.80	- a/	12.86	42.86 b/
II. Consultancy & Training for Bangladesh Bank & Credit Institutions					
- Consultancy (2 man-years)	0.20	-	0.01	-	0.31
- Training (foreign & local)	0.06	-	0.03	-	0.09
Subtotal(II)	0.26	-	0.04	-	0.40
III. BSCIC - Promotion and Extension					
- Subcontracting Exchange	0.08	0.12	0.10	-	0.30 c/
- Subsector Schemes	0.27	0.40	0.05	-	0.72 d/
- Pilot Projects	0.42	0.12	0.05	0.12	0.71 e/
- Decentralization	-	-	0.35	-	0.35 f/
Subtotal (III)	0.77	0.64	0.55	0.12	2.08
IV. EPB - Handicraft & Light Industrial Export & Product Development Fund					
- Consultancy	0.20	0.20	-	-	0.40
- Sales and Exposure Trips	0.40	-	-	0.10 g/	0.50
- Staff	-	-	0.10 h/	-	0.10
Subtotal (IV)	0.60	0.20	0.10	0.10	1.00
V. IRDP Rural Enterprise Development					
- Technical Services by IRDP and TCCA	0.01 i/	0.02	0.07 j/	-	0.30
VI. Planning Commission - Study on Rural Enterprise Potential and Institutions	0.20	0.20	0.40	-	0.80 k/
VII. Leather Technology Institute - Common Service Facility					
- Facilities, equipment	0.92	0.48	0.66	-	1.96
- Consultancy, training	0.23	0.10	0.10	-	0.60
Subtotal (VII)	1.05	0.58	0.76	-	2.56
Unallocated	0.47	-	-	-	0.47
TOTAL	20.56	14.44	1.92	13.08	50.00

a/ Bangladesh Bank would use its resources as a revolving fund to cover the gap between refinancing by Bangladesh Bank and withdrawals from IDA. Bangladesh Bank and the participating banks would incur expenditures for direct SCI staff and overheads in appraisal, supervision, and collections. These administrative costs would be covered with the spreads.

b/ Subloan components include specific minimum allocations for export and rural enterprises.

c/ IDA contribution would include consultancy, outside training and equipment for subcontracting exchange. GOB/implementing agency contribution would include staff for BSCIC's subcontracting exchange, cost of land and buildings, engineers of selected public sector corporations allocated to subcontracting work and overhead expenditures.

d/ Includes consultancy services.

e/ About ten "new style" pilot projects would be sponsored. Private sponsor would contribute 10-70% of project costs (through equity or loan); BSCIC would finance the remaining portion. Average project cost would be Tk. 800,000 in fixed assets.

f/ These are total costs. BSCIC would need to determine portion of decentralized staff to be redeployed vs. recruitment.

g/ Private participants would pay an estimated 20% of sales and exposure trips.

h/ GOB would need to finance a revolving fund within EPB's Export and Product Development Fund to cover the gap between EPB's payments for sales and exposure trips and withdrawals from IDA. The revolving fund should be of at least Tk. 1,000,000. Estimated staff and overheads by EPB to execute elements of the Export Fund are Tk. 450,000 for three years.

i/ IDA would finance outside consultancy (5 man-months) for IRDP and TCCA rural enterprise staff.

j/ Includes estimates for IRDP and TCCA rural enterprises staff, supervisors, and overheads to operate the program.

k/ Assumes five man-years of consultancy. Assumes 40 fulltime management, research, and analyst staff employed for three years, plus overhead expenditures.

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THIRD SMALL SCALE INDUSTRY PROJECT

Estimated Schedule of Disbursements
for the Proposed Credit

<u>IDA Fiscal Year and Quarter</u>	<u>Disbursements in SDR 000 (US\$ 000)</u>	
	<u>By Quarter</u>	<u>Cumulative</u>
<u>FY81</u>		
To March 31, 1981	2,100 (2,753)	2,100 (2,753)
June 30, 1981	2,000 (2,622)	4,100 (5,375)
<u>FY82</u>		
To September 30, 1981	2,300 (3,015)	6,400 (8,390)
December 31, 1981	3,100 (4,064)	9,500 (12,454)
March 31, 1982	2,600 (3,408)	12,100 (15,862)
June 30, 1982	2,700 (3,540)	14,800 (19,402)
<u>FY83</u>		
To September 30, 1982	2,900 (3,801)	17,700 (23,203)
December 31, 1982	2,900 (3,801)	20,600 (27,004)
March 31, 1983	2,700 (3,540)	23,300 (30,544)
June 30, 1983	1,900 (2,491)	25,200 (33,035)
<u>FY84</u>		
To September 30, 1983	800 (1,048)	26,000 (34,083)
December 31, 1983	400 (524)	26,400 (34,607)
March 31, 1984	300 (393)	26,700 (35,000)

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THIRD SMALL SCALE INDUSTRY PROJECT

SUPPORTING DOCUMENTS AVAILABLE IN PROJECT FILES

1. Sectoral and Policy Analysis

- (a) Manufacturing Census, 1974, Bureau of Statistics.
- (b) Small Industry Census, BSCIC, 1978/79.
- (c) Rural Enterprise Study Report, Bangladesh Institute of Development Studies, 1979.
- (d) Subsector Study on Engineering, BSCIC and JICA.
- (e) Outline of Action Program.

2. Subloan Component

- (a) Annual Reports: Bangladesh Bank, Janata, Sonali and Agrani Bank, BSB.
- (b) Resume of the Financial Institutions (Fifth Issue) 1978-79, Bangladesh.
- (c) Completed questionnaire on Sonali, Janata, and Agrani Banks.
- (d) Supervision Report on BSB, December 1979.
- (e) Summary of subprojects approved and in pipeline by Sonali, Janata under Credit 825-BD as of February 29, 1980.
- (f) Relevant circulars by Sonali and Janata Bank on its SCI operations and procedures.
- (g) Bangladesh Bank Small Industry Credit Guarantee Scheme and List of Required Revisions.
- (h) Draft Terms of Reference for Advisors and Consultants.
- (i) Project Completion Report for First SSI Project (Credit 353-BD).

3. Technical and Marketing Components

- (a) Draft Strategy Statement Small Scale Industries for Second Five Year Development Plan.
- (b) BSCIC - Administrative Scheme and Summary of Strategy, Organization, Staff and Budget.
- (c) Tentative Plan for Decentralization of Extension Staff.
- (d) Outline of Training Program, Extension Staff.
- (e) Export Growth Strategy of Bangladesh.
- (f) Summary of Organization, Staffing, Program and Budget of Export Promotion Bureau.
- (g) GOB Committee Report on Prospects in the Leather Sector.
- (h) Summary of Organization, Staff, Program and Budget - Institute of Leather Technology.
- (i) Progress Reports on Integrated Rural Development Program.