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Original Research Article

The Role of SME Banking in Poverty Reduction and Financial Development in Bangladesh

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ABSTRACT

This research investigates the influence of Small and Medium-sized Enterprise (SME) banking on poverty alleviation and financial development in Bangladesh. Utilizing a qualitative methodology, the study conducted in-depth interviews with eight purposively selected experts based in Dhaka, Bangladesh. These participants included professionals from SME banking sectors, financial development policymakers and regulators, development practitioners engaged with SMEs, and academics specializing in SME finance and development. The data collected underwent a rigorous content analysis, revealing that Bangladesh's significant economic growth has been largely driven by SME development, which has positively impacted GDP and employment rates. SME banking has played a crucial role in this growth by providing essential financial services that support business expansion and innovation. Additionally, SME banking has promoted financial inclusion by specifically targeting historically underserved communities, contributing to a more equitable and thriving society. The findings of this study enhance the existing literature on the role of SME banking in poverty reduction and financial development. The insights gained have substantial implications for policymakers, financial institutions, and the academic community both within Bangladesh and in a broader international context.

Introduction

The intricate relationship between financial development and poverty alleviation is increasingly recognized in developing countries, with Small and Medium-sized Enterprises (SMEs) at the heart of this nexus (Hou & Fang, 2023; Elumah et al., 2024). SMEs are globally defined by various criteria such as total and fixed assets, sales volume, workforce size, or a blend of these elements. Employee count is the most common metric, with the European Union categorizing SMEs as entities with up to 250 employees, while the United States considers businesses with fewer than 500 employees as SMEs. These enterprises play pivotal roles in job creation, economic growth, and innovation, establishing themselves as crucial agents in global socioeconomic progress (Fiseha & Oyelana, 2015; Jangjarat & Jewjinda, 2023). In Bangladesh, SMEs account for a substantial portion of industrial employment and manufacturing value addition. However, access to finance remains a significant obstacle, hindering their growth and sustainability. SME banking has emerged as a key tool to provide financial services tailored to the needs of small and medium businesses. Over the past few decades, Bangladesh has made remarkable progress in reducing poverty, attributed to various factors including the growth of the SME sector and the expansion of financial services to underserved segments of the population. SME banking has played a vital role by providing access to credit, savings products, and other financial services to entrepreneurs, enabling them to start and grow their businesses (Alauddin & Chowdhury, 2015; Hasan & Jamil, 2014; Yuan et al., 2019; Rahman & Khondkar, 2020).

Despite progress, poverty remains a significant challenge in Bangladesh, particularly in rural areas. Financial inclusion is still limited, with a large portion of the population lacking access to formal banking services. It is essential to examine the effectiveness of SME banking in addressing these issues and identify areas for improvement. Previous studies, such as those by Rouf and Islam (2015) and Rahman (2016), have explored SME banking in Bangladesh, highlighting impediments and prospects within the framework. However, few have qualitatively examined the nexus between SME banking, poverty alleviation, and financial development in Bangladesh. Hence, this study employs a qualitative research paradigm to elucidate the role of SME banking in mitigating poverty and fostering financial development in Bangladesh. Through a comprehensive analysis of SME banking practices, the research aims to expand the existing body of literature on the pivotal functions of SME banking in poverty alleviation and financial development. The study's findings offer nuanced insights into the mechanisms through which SME banking contributes to economic upliftment and financial inclusion. These insights are invaluable for policymakers, financial institutions, and researchers, providing a robust foundation for formulating strategies and policies that leverage SME banking as a tool for economic development, both within Bangladesh and in broader international contexts. The research methodology includes in-depth interviews with key stakeholders, critical reviews of

secondary data, and the application of documentary methods to ensure a thorough and multifaceted understanding of the subject matter.

Objectives

To the influence of Small and Medium-sized Enterprise (SME) banking on poverty alleviation and financial development in Bangladesh.

Research Methodology

This study adopted a qualitative approach to explore how SME banking contributes to poverty reduction and financial development in Bangladesh. This research paradigm is meticulously designed to uncover the underlying motivations, contextual factors, and nuances influencing the behaviors and decision-making processes of individuals or groups. Emphasizing the critical role of dynamic interaction during interviews, this approach facilitates the acquisition of extensive, multifaceted data, thereby reinforcing the findings of seminal research in this field. To enhance the depth of insights relevant to the central research objectives, this inquiry employed the documentary method alongside in-depth interviews to collect primary data. This included a comprehensive critical review of existing secondary data sources, allowing for the precise formulation of survey questions directly aligned with the research focus (Kraiwanit et al., 2023; Limna, 2023; Thetlek et al., 2024). Hence, the research focused on in-depth interviews and documentary methods for data collection and analysis.

In-depth interviews were conducted with eight purposively selected experts from Dhaka, Bangladesh. Participants included SME banking professionals, policymakers, development practitioners, and academics. For the documentary method, relevant secondary data sources, such as reports from the Bangladesh Bank and other financial institutions, were reviewed to complement the primary data. Purposive sampling entails the researchers selecting the most helpful sample based on their expertise. This method is frequently used in qualitative research. The goal is to gain in depth knowledge about a specific phenomenon or population (Siripipatthanakul et al., 2022). Purposive sampling was used to select participants with relevant knowledge and experience. This approach ensured valuable insights into the role of SME banking in Bangladesh. The study's sample comprised eight participants, each over the age of 18. These participants included professionals from SME banking sectors, financial development policymakers and regulators, development practitioners engaged with SMEs, and academics specializing in SME finance and development, based in Dhaka, Bangladesh. Content analysis was employed to systematically identify, categorize, and analyze themes within the interview data. This method allowed for the extraction of meaningful inferences from participants' responses (Asanprakit & Limna, 2023; Limna et al., 2024; Thetlek et al., 2024).

Result

The study's interviews were conducted with eight participants, each over the age of 18, based in Dhaka, Bangladesh. These participants included professionals from SME banking sectors, financial development policymakers and regulators, development practitioners engaged with SMEs, and academics specializing in SME finance and development. The themes explored during the interviews were as follows:

Sustainable Economic Growth in Bangladesh

Bangladesh has witnessed remarkable long-term economic growth, creating an environment highly conducive to the development of SME banking. This growth is not merely a reflection of increased industrial activities but also signifies improved socio-economic standards, heightened investor confidence, and progressive governmental policies aimed at fostering entrepreneurship. The expansion of SMEs is central to Bangladesh's economic development strategy, significantly contributing to GDP and promoting the diversification of economic activities. SMEs stimulate private ownership and entrepreneurial skills, which are crucial for economic dynamism and innovation. Furthermore, the SME sector has been instrumental in creating numerous job opportunities, thereby reducing unemployment rates and enhancing the standard of living for many Bangladeshis. As more individuals gain employment, household income levels rise, leading to increased consumer spending and savings. This upsurge in economic activity generates a cascading effect, boosting demand for goods and services, which, in turn, propels further industrial growth and creates a virtuous cycle of economic development. Additionally, the thriving SME sector fosters financial development by expanding the customer base for banks and financial institutions. This diversification into SME banking aids in risk management and contributes to the stability and sustainability of the financial sector. By providing financial products and services tailored to the needs of SMEs, banks play a critical role in enabling these enterprises to access capital, invest in innovation, and expand their operations. Overall, the significant economic upswing in Bangladesh has been substantially supported by SME development. Central to this growth has been SME banking, which has provided essential financial services underpinning business expansion and innovation. Moreover, this banking sector has been instrumental in fostering financial inclusion, specifically targeting historically underserved communities, thereby contributing to a more equitable and thriving society.

Easy Access to Finance through SME Banking

SME banking has emerged as a crucial facilitator in providing easy access to finance for small and medium-sized enterprises in Bangladesh. These enterprises are the backbone of the economy, driving innovation, creating employment, and contributing significantly to GDP. However, one of the most significant barriers these entities face is limited access to financial resources. SME banking addresses this gap by offering a range of tailored financial products and services specifically designed to meet the unique needs of small businesses. These services

include microcredit, which provides small loans to entrepreneurs to start or expand their businesses, and working capital loans, which offer necessary funds to cover day-to-day operations. Additionally, SME banking provides various business advisory services that help entrepreneurs navigate the complexities of running a business. By providing these specialized services, SME banking not only increases access to finance for small businesses but also enables them to invest in productive activities. This includes purchasing equipment, hiring staff, and expanding operations, which in turn contributes to overall economic growth. The infusion of capital and support from SME banking leads to job creation, helping to reduce unemployment rates and improve living standards within the community. Furthermore, SME banking fosters entrepreneurship and economic self-sufficiency by empowering individuals to establish and grow their businesses. This is particularly important in developing economies like Bangladesh, where large portions of the population may not have access to traditional employment opportunities. Through the provision of financial and advisory services, SME banking supports these entrepreneurs, promoting innovation and competition within the market. Moreover, SME banking plays a crucial role in promoting the ease of doing business. By investing in SME loans, banks and financial institutions facilitate the expansion and diversification of the economy. This aids in the growth of the SME sector and enhances the overall business environment, making it more conducive for new and existing businesses to thrive. Thus, SME banking significantly contributes to the economic development of Bangladesh by providing essential financial support to small businesses, fostering innovation, and promoting a more inclusive and dynamic economy.

Financial Inclusion through SME Banking

SME banking plays a pivotal role in advancing financial inclusion in Bangladesh, a fundamental aspect of reducing poverty and boosting prosperity. By extending banking services and credit to previously underserved segments of the population, such as women entrepreneurs, rural communities, and marginalized groups like the transgender community, SME banking helps bridge significant gaps in economic participation. Women entrepreneurs often face greater barriers in accessing capital due to socio-cultural norms and discrimination. SME banking addresses these challenges by providing targeted financial services, training, and support, empowering women to start and grow their businesses. This empowerment leads to economic independence and enhances the well-being of their families and communities. Similarly, rural communities, which traditionally suffer from a lack of access to financial services, benefit significantly from the expansion of SME banking. By reaching out to these areas with tailored financial products, such as agricultural loans or microfinance options, banks can stimulate local economies, encourage the growth of small-scale enterprises, and foster community development. The inclusion of marginalized groups, such as the transgender community, is equally important. Historically excluded from mainstream financial and economic systems, transgender individuals face significant barriers to economic participation. By prioritizing these groups under SME schemes, banks help alleviate poverty, reduce income

inequality, and provide opportunities for social and economic mobility within these communities. In addition to providing access to capital, SME banking offers a range of non-financial services crucial for the success of small enterprises. These include financial literacy programs, business training, and mentorship, all of which enable underserved entrepreneurs to navigate the business landscape successfully. The impact of SME banking on financial inclusion is profound. By democratizing access to financial services, SME banking not only fosters economic growth and job creation but also contributes to a more equitable society. It ensures that a broader segment of the population can participate in and benefit from economic activities, thereby driving the overall development of Bangladesh. Through targeted initiatives and inclusive financial products, SME banking plays an essential role in bridging the financial divide and promoting a more inclusive and thriving economy.

Discussion

Access to finance remains a major barrier for SMEs, but SME banking has emerged as a crucial solution. By offering a range of tailored financial products and services, SME banking addresses the unique needs of small businesses. Services such as microcredit, working capital loans, and business advisory services enable SMEs to invest in productive activities, expand their operations, and create jobs. This financial support leads to broader economic growth, reduces unemployment, and enhances living standards. SME banking also fosters entrepreneurship and economic self-sufficiency, empowering individuals to start and grow their businesses. This is particularly important in a developing economy like Bangladesh, where traditional employment opportunities may be limited. By investing in SME loans, banks and financial institutions facilitate the expansion and diversification of the economy, enhancing the overall business environment (Hasan & Jamil, 2014; Alauddin & Chowdhury, 2015; Yuan et al., 2019).

Financial inclusion is another critical area where SME banking has made substantial strides. By extending banking services and credit to underserved segments of the population, such as women entrepreneurs, rural communities, and marginalized groups like the transgender community, SME banking bridges significant gaps in economic participation. Women entrepreneurs benefit from targeted financial services, training, and support, which empower them to start and grow their businesses, leading to economic independence and improved community well-being. Similarly, rural communities benefit from tailored financial products, such as agricultural loans or microfinance options, which stimulate local economies and foster community development. The inclusion of marginalized groups, such as the transgender community, is also crucial. Historically excluded from mainstream financial systems, these individuals face significant barriers to economic participation. By prioritizing these groups, SME banking helps alleviate poverty, reduce income inequality, and provide opportunities for social and economic mobility.

The profound impact of SME banking on financial inclusion cannot be overstated. By democratizing access to financial services, SME banking fosters economic growth, job creation, and a more equitable society. It ensures that a broader segment of the population can participate in and benefit from economic activities, driving the overall development of Bangladesh. Through targeted initiatives and inclusive financial products, SME banking plays an essential role in bridging the financial divide and promoting a more inclusive and thriving economy (Rahman, 2016; Rouf & Islam, 2015).

The study underscores the pivotal role of SME banking in driving economic growth, providing easy access to finance, and advancing financial inclusion in Bangladesh. The findings highlight the significant contributions of SME banking to GDP growth, job creation, and poverty alleviation. By supporting business expansion, innovation, and financial inclusion, SME banking fosters a more equitable and prosperous society. These insights offer valuable implications for policymakers, financial institutions, and researchers, emphasizing the need for continued support and expansion of SME banking to sustain economic growth and promote financial inclusion (Quaye et al., 2014; Eton et al., 2021).

By continuing to support and expand SME banking initiatives, Bangladesh can build on its successes and address remaining challenges, ensuring that the benefits of economic growth and financial inclusion are shared broadly across all segments of society. The commitment to fostering a thriving SME sector and inclusive financial services will be crucial in shaping a prosperous, resilient, and inclusive future for Bangladesh. Future research should consider expanding the geographical scope beyond Dhaka to include participants from other regions of Bangladesh to provide a more comprehensive understanding of SME banking's impact across different contexts. Employing a mixed-methods approach could enhance the robustness of the findings by combining qualitative insights with quantitative data. Additionally, investigating the perspectives of SME owners and clients of SME banks could provide a fuller picture of the sector's impact and areas for improvement. Comparative studies involving other developing countries could also shed light on unique challenges and successful strategies, contributing to a global understanding of SME banking's role in economic development.

Conclusion

This study explored the role of SME banking in poverty reduction and financial development in Bangladesh. The findings indicate that SME banking has significantly contributed to sustainable economic growth, facilitated easy access to finance, and advanced financial inclusion in the country.

The trajectory of Bangladesh's economic growth has been substantially bolstered by the development of the SME sector, which is supported by a robust SME banking framework. SMEs have proven to be a cornerstone of Bangladesh's economic strategy, contributing significantly to GDP and fostering diversification of economic activities. They have stimulated private ownership, entrepreneurial skills, and innovation, which are crucial for economic dynamism

(Hou & Fang, 2023; Elumah et al., 2024). Furthermore, SMEs have played an instrumental role in job creation, reducing unemployment rates, and improving living standards. This economic upliftment is reflected in the increased household incomes, which further stimulate consumer spending and savings, creating a virtuous cycle of economic development. SME banking has facilitated this growth by providing essential financial services that support business expansion and innovation, contributing to a stable and sustainable financial sector (Fiseha & Oyelana, 2015; Jangjarat & Jewjinda, 2023).

Recommendations

To foster a thriving SME environment in Bangladesh, it is essential to overhaul and simplify the current regulatory framework. Establishing a unified portal for all SME-related governmental services, including registration, licensing, and taxation, can significantly reduce the administrative burden on small businesses. Introducing a tiered regulatory approach will ensure that smaller enterprises face fewer hurdles, encouraging business growth and innovation. Collaboration between regulatory bodies and SME associations is vital to ensure that new regulations support, rather than impede, SME development. Expanding financial inclusion requires creating and promoting financial products specifically designed for underserved groups such as women, rural inhabitants, and marginalized communities. This initiative should be coupled with targeted financial literacy programs to ensure these groups can fully utilize the services offered. Providing incentives, such as subsidies or tax benefits, can encourage financial institutions to develop more inclusive banking environments that meet the diverse needs of all population segments. Advancements in digital infrastructure are crucial for the evolution of SME banking. Strengthening national digital networks ensures that SMEs, particularly in remote areas, have access to reliable online services. Supporting fintech innovations that address specific challenges faced by SMEs can revolutionize how these businesses engage with financial services, making transactions more accessible and efficient. Encouraging traditional banks to develop digital tools tailored for SMEs will further enhance the sector's competitiveness and operational efficiency. Empowering SME owners with necessary business and financial management skills is fundamental to their growth and sustainability. Collaborative efforts between the government, educational sectors, and private organizations can provide SMEs with valuable resources such as workshops, mentorship, and access to information. Special emphasis should be placed on programs that empower women and youth, ensuring that all population segments can contribute to and benefit from economic growth. For SMEs to thrive, they need opportunities to expand beyond local markets. Government and private sector initiatives should aim to facilitate SMEs' access to domestic and international markets through trade fairs and online platforms. Providing support for meeting international standards can open new doors for export opportunities, while partnerships with foreign entities can ease entry into new markets. These measures not only boost SME growth but also contribute to the broader economic development of Bangladesh. By implementing these

suggestions, Bangladesh can enhance the effectiveness of SME banking, ensuring that it continues to drive economic growth, improve financial inclusion, and reduce poverty. These initiatives will help build a more resilient and inclusive economy, benefiting all segments of society.

Limitations and Recommendations for Future Studies

This study, while providing insightful findings, has several limitations. The qualitative methodology, focusing on in-depth interviews with only eight participants from Dhaka, may not capture the full spectrum of experiences within the SME banking sector across Bangladesh. The limited sample size and geographic focus restrict the generalizability of the results. Additionally, the purposive sampling technique and reliance on self-reported data introduce potential biases. To address these limitations, future research should expand the geographical scope, include a more diverse range of participants, and employ a mixed-methods approach to enhance the robustness and validity of the findings. By incorporating these recommendations, future studies can provide a more comprehensive understanding of SME banking's role in poverty reduction and financial development both within Bangladesh and in broader contexts.

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