Bangladesh Garments Accessories and Packaging Manufacturers & Exporters Association (BGAPMEA)

Final Report
on
Background paper on Policy & Regulatory issues for Advocacy and Lobbying

Study-I
Financing the Garment Accessories and Packaging (GAP) Sector: Constraints, Possibilities, Remedial Measures and Policy Decision.

under Bangladesh INSPIRED Programme
SME Competitiveness Grant Scheme

Submitted on July, 2016

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Funded by

The European Union

Ministry of Industries
Govt. of the Peoples Republic of Bangladesh

Study on the Financing The Garment Accessories and Packaging (GAP) Sector: Constraints, Possibilities, Remedial Measures and Policy Directives

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Study on the Financing The Garment Accessories and Packaging (GAP) Sector : Constraints, Possibilities, Remedial Measures and Policy Directives

Chapter-1

1.0 Introduction

1.1 Background

The RMG sector of Bangladesh has exhibited a phenomenal growth during last two decades. Due to its extraordinary performance, Bangladesh has earned the position of second largest garment exporters of the world with 5% global market share only; next to China enjoying 31% of the share of total global market of US$ 450 billion. Thus, although Bangladesh occupies the second largest position, its market share is only one sixth of China, showing a very wide gap.

Until the early 1960s, the apparel industry in the developed countries like the US and UK relied on domestic subcontracting; cutting and stitching operations were subcontracted to small garment factories which mostly used cheap female labour, while large-scale merchandising was undertaken by larger firms. Subsequently, as industrial wages began to rise, the apparel retailers in the developed countries found it more profitable to relocate production to lower-wage developing countries; in most cases, such out-sourcing took the form of subcontracting arrangements between the retailers in the developed countries and the garment manufacturers in the developing countries. The retailers in the developed countries placed work-orders to the offshore garment manufacturers, often through buying agents, and they also helped the garment makers in various ways to produce and ship the merchandise. Such sub-contracting reduced the risk of doing business with foreign partners since it did not require any foreign direct investment. In essence it was a triangular trade between the garment manufacturers and the foreign buying agents on the one hand, and the retailers and the buying agents on the other.

Packaging and Garments accessories constitute the most crucial determinants of quality of garment products. As a result, accessories & packaging industries provide underpinnings to the growth and expansion of each sector of the economy. A high degree of potential exists for almost all the user segments which are expanding appreciably. Fabrics and garments, consumer goods and other durables, processed foods, hard and soft drinks, fruit and marine products, cosmetics and personal care, office stationary and accessories, electrical appliances and equipments, entertainment and other electronics, shoes and leather ware, gems and jewelry, toys and sports goods, chemicals and fertilizers, etc. are the important sectors using large quantity of accessories and packaging materials. Due to lower manufacturing costs, Bangladesh is fast becoming a preferred hub for accessories and packaging production. So garment accessories & packaging although constitute insignificant percentage of cost of the products, occupies most important position in production economics. These add aesthetic value to the garments products which justifies the claim “accessories and packaging qualify the products”.

In the export market, contribution of packaging & accessories is very important. In many cases, these units are located within the mainstream industrial units; for instance packaging & accessories of medicine is an integral part of pharmaceutical industry, many garment factories have their manufacturing facilities of poly, sticker etc. In Bangladesh, there are large numbers of small, medium and cottage-based independent packaging and accessories industrial units scattered all over the country.

1.2 Objectives and Scope

Objectives:

The study aims at ensuring easy access to investment and working capital funds, adoption of user-friendly policy regime by different Ministries and Departments, etc.

Scope:

The scope of the study encompasses the following issues:

- Review of prevailing needs and sources of investment and working capital funds GAP Sector;
- Review the constraints, including reasons of investment and working capital funds of GAP Sector;
- Review extent of non-accessibility, hurdles and discriminations, including their reasons against GAP Sector in availing the Export Development Fund (DEF) and various other funds; and
- Recommend user-friendly regulatory and policy issues for bringing necessary and effective improvement in the accessibility of the member units of GAP Sector to the existing Funds, including introduction of new and innovative Funds to support the GAP Sector in reducing cost, raising productivity and improving competitiveness in the international market.

The key conceptual issues in the approach are:

- Overview and assess the needs and sources of investment and working capital funds GAP Sector;
- Identify the constraints, including reasons of investment and working capital fund requirements of GAP Sector;
- Determine the extent of non-accessibility, hurdles and discriminations, including their reasons against GAP Sector in availing the Export Development Fund (DEF) and various other funds; and
- Recommend user-friendly regulatory and policy issues for bringing necessary and effective improvement in the accessibility of the member units of GAP Sector to the existing Funds, including introduction of new and innovative Funds to support the GAP Sector in reducing cost, raising productivity and improving competitiveness in the international market.

1.3 Methodologies and Instruments

The methodology used in conducting this study include, among other, the following:

1.3.1 Data Requirements

Based on the study objectives, the data requirement for justifying each relevant issue have been ascertained.

1.3.2 Data Collection

A number of data collection instruments have been used to collect the necessary data, namely:

- Questionnaire;
- Checklist;
- Depth Interview;
- Focus Group Discussion, in case of necessity.

1.3.3 Data Processing

Statistical methods have been used for tabulation and processing of data for the study.

1.3.4 Data Analysis

Data have been analyzed to reach the study conclusions in keeping with the study objectives and field information. All out efforts have been made to analyze the data in its real perspective. Each of these issues has been described in the following sections.

1.3.5 Principal Activities / Tasks and Corresponding Methodology

The principal activities/tasks and corresponding methodology of conducting various tasks are presented below:

Sl. No.	Tasks/Activities	Study Methods applied	Study Instruments/ Tools used
01	Assessing the needs and sources of investment and working capital funds for GAP Sector.	Exploring secondary sources and consulting data received from these sources of data;	Pre-designed Checklist to collect short profile of GAP Units
02	Identifying the constraints, including reasons of investment and requirement of working capital funds of the GAP Sector.	i)Exploring both primary and secondary sources ii) Consultation and review the data collected from these sources.	i) Pre-designed Checklist to collect short profile of GAP Units; ii) Pre-designed Questionnaire (emphasizing on reasons of investment, working capital requirement) for use at the sample GAP Units;

			iii) Pre-designed Checklist of aspects for discussion with Key Informants (KIs) from Association Offices.
03	Assess & determine the extent of non-accessibility, hurdles and discriminations, including reasons affecting GAP Sector in availing the Export Development Fund (EDF) and various other funds.	Exploring both primary and secondary sources regarding extent of non-accessibility, hurdles and discriminations, including reasons affecting GAP Sector in availing the Export Development Fund (DEF) and various other funds;	i) Pre-designed Checklist to collect short profile of the GAP Units **ii)** Pre-designed Questionnaire for collection of data from the GAP Units concerning hurdles of access to funds and discrimination affecting GAP Units.
04	Recommend user-friendly regulatory and policy issues for bringing necessary and effective improvement in the accessibility of the member units of GAP Sector to the existing Funds, including introduction of new and innovative Funds to support the GAP Sector in reducing cost, raising productivity and improving competitiveness in the international market.	Review and analysis of data outcome derived from Sl. 01, Sl. 02 and Sl. 03 through brain storming, forming and norming process among consultants.	Standard practice, keeping in view prospective needs

1.3.6 Study Instruments/Tools used in the Study

The following Instruments/Tools have been used in the study:

- Review the status of GAP units and their fund requirements, availability, inhibiting elements, etc;
- Checklist to collect relevant policy guidelines and regulatory issues;
- Checklist to collect data concerning fund requirement of individual GAP unit, fund applied for, fund approved and disbursed to individual unit, mode of disbursement, time consumed between loan applied for and fund released;
- Checklist to discuss with sample financial institutions on relevant issues, including their views and suggestions for overcoming the relevant problems and hurdles ;
- Checklist to discussion with concerned officials of Bangladesh Bank on relevant issues, including their views and suggestions for overcoming the relevant problems and hurdles ;

1.3.7 Sources of Data Collection

Both Primary and Secondary Sources of data collection have been used.

Secondary Sources: Published reports, records, study reports, statistical reports on the issues have been utilized for collection of secondary data.

Primary Data: Specially designed questionnaire, checklist, discussion with BGAPMEA officials, unit management, bank officials, (including commercial banks, financial institutions etc.). Bangladesh Bank officials etc. have been used for collecting primary data.

Chapter-2

2.0 Review and Analysis of the GAP Sector, Its Investment and Fund Requirements

2.1 GAP Industries in Bangladesh

Bangladesh is aiming at exporting RMG for US$ 50 billion by the year 2021. On average garment accessories and packaging products contribute about 16% to RMG export earnings. Under this corollary and assumption, the export earnings from Garments Accessories and Packaging sector have been estimated to arrive at $18.0 billion in 2025. If the packaging and accessories could be exported directly together with deemed exports, the figure may even assume much higher figure and may stand as a parallel industry sector with RMG in terms of earnings.

The following table exhibits the typical category of Accessories & Packaging Industries in Bangladesh

Table-2.1 (a): Number and Categories of Accessories & Packaging Manufacturing Units under BGAPMEA.

Sl. No.	Categories of Industries	No. of Units
01.	Button	25
02.	Chemical	01
03.	Corrugated Carton	651
04.	Elastic & Drawstring	109
05.	Embroidery	02
06.	Gum Tape	03
07.	Hanger	08
08.	Interlining	07
09.	Multi Items	194
10.	Packaging	25
11.	Padding	03
12.	Poly	134
13.	PP Band	01
14.	Labels	39
15.	Quilting & Padding	01
16.	Resin	01
17.	Sewing Thread	72
18.	Screen Print	04
19.	Zipper	20
Total		**Total : 1300**

In order to cater to the demands of the garments sector, capacity of the GAP sector should be scaled up through increasing operational capacity and efficacy of the existing industrial units and also developing new enterprises.

2.2 Growth Trend

Bangladesh, with its outstanding efforts, would be able to export RMG for US$ 50 billion by year 2021.Apparel export to non-traditional markets rose to US$ 3.5 billion in 2013 from merely US$ 800 million in 2008. This was a dramatic increase in last 6 years time and the result of serious entrepreneurial initiative and concomitant of government incentive package to exporters for exploring new destinations for their products. Under this corollary and assumption, the Garments accessories and packaging products export earnings were found to increase from US$1.8 billion in 2008-09 to US$ 4.76billion in 2013-14. If packaging and accessories could be exported directly together with deemed exports the figure would assume greater dimension and would stand as a parallel industry sector with RMG in terms of earnings.

Table-2.2 (a): Export Performance of Garments Accessories & Packaging Industries during last 5 yrs. (2008-09 to 2013-14)

Fiscal Year	Total Export Earning (in mn US$)	RMG Export Earning (in mn US$)	Share of RMG as % of Total Export	Export of Accessories &Packaging (in mn US$)
2005-06	10526.16	7900.80	75.06	1185.12
2006-07	12177.86	9211.23	75.64	1381.68
2007-08	14110.80	10699.80	75.83	1604.97
2008-09	15565.19	12347.77	79.33	1852.17
2009-10	16204.65	12796.72	77.12	1919.51
2010-11	20628.73	18340.89	78.10	2751.13
2011-12	23704.19	20360.05	78.80	3075.00
2012-13	27027.36	21515.73	79.61	4100.00
2013-14	30186.62	24491.88	81.14	4750.00

(Data source: Export Promotion Bureau)

Considering the RMGs' growth trend along with the domestic demand for garments accessories and packaging products , GAP industries are estimated to grow at rate of 23%. The following table 2.2(b) shows the projected export trend of garments accessories & packaging industries.

Table: 2.2 (b): Projected Trend of Export of Garments Accessories & Packaging Industries during 5 years (2014-15 to 2018-19)

Year	Export (in million US$)
2014-2015	5,843
2015-16	7,187
2016-17	8,840
2017-18	10,873
2018-19	13,373
Average	9,223

2.3 Current Investment Scenario

The following table-2.3 (a) shows existing investment outlay in nineteen categories of garments accessories and packaging products manufacturing units. Subsector-wise investment analysis illustrates that the highest investment took place in Zipper and multi-item manufacturing units. Investment in individual Zipper and multi item manufacturing unit stands at about TK.500 million while Embroidered and Gum manufacturing units ranked the lowest investment.

Table-2.3 (a): Current Investment Scenario of Accessories & Packaging Manufacturing Units under BGAPMEA.

Sl. No	**Different Subsector of BGAPMEA**	**No. of Units under different subsector**	**Investment (in million Tk.)**
01.	Button	25	10,000
02.	Chemical	01	100
03.	Corrugated Carton	651	1,62,750
04.	Elastic & Drawstring	109	32,700
05.	Embroidery	02	60
06.	Gum Tape	03	90
07.	Hanger	08	240
08.	Interlining	07	560
09.	Multi Items	194	97,000
10.	Packaging	25	1250
11.	Padding	03	180
12.	Poly	134	8040
13.	PP Band	01	60
14.	Labels	39	1950
15.	Quilting & Padding	01	80
16.	Resin	01	70
17.	Sewing Thread	72	2880
18.	Screen Print	04	120
19.	Zipper	20	10000
			328130

2.3.1 Long term and Working Capital Investment in the GAP industries

The table-2.3.1 shows the long term and working capital investment in garments accessories and packaging industries manufacturing units. The Consultants conducted a Focused Group Discussion (FGD) attended by selected knowledgeable entrepreneurs and Senior Officials of BGAPMEA. In the discussion, a set of indicative data was generated. Based on these sub sectoral projection, long term capital investment and working capital have been calculated.

Table2.3.1: Long term and Working Capital Investment in the GAP industries

Sl. No.	Categories of Industries	No. of Units	Long term Investment (in million Tk.)	Working Capital (in million Tk.)	Total Investment (in million Tk.)
01.	Button	25	6000	4000	10000
02.	Chemical	01	50	50	100
03.	Corrugated Carton	651	81375	81375	162750
04.	Elastic & Drawstring	109	18000	14700	32700
05.	Embroidery	02	40	20	60
06.	Gum Tape	03	45	45	90
07.	Hanger	08	144	96	240
08.	Interlining	07	330	230	560
09.	Multi Items	194	37000	60000	97000
10.	Packaging	25	750	500	1250
11.	Padding	03	90	90	180
12.	Poly	134	4020	4020	8040
13.	PP Band	01	30	30	60
14.	Labels	39	975	975	1950
15.	Quilting& Padding	01	48	32	80
16.	Resin	01	28	42	70
17.	Sewing Thread	72	1440	1440	2880
18.	Screen Print	04	60	60	120
19.	Zipper	20	6000	4000	10000
		Total : 1300	**156425**	**171705**	**328130**

The above table 2.3.1shows that manufacturing units like- button, zipper, elastic drawstring interlining, packaging, quilting padding need more long term capital than other units indicating that these manufacturing units use high valued capital machineries. Another analytic observation is that the manufacturing units having low margin need more working capital than the units generating high margin. Working capital requirements also depend on other factors like- speedy disposal of bills against L/C, easy access to utilization permission concerned with import of raw materials etc.

2.3.2 Factors affecting Fund Requirements

Garment accessories and packaging manufacturing units need long-term fund for procurement of machineries. For import of raw materials, these industries need to deposit L/C margin in L/C opening bank. In assessing total fund requirements, both long and short term funds requirement of an individual unit are taken into consideration. In a discussion meeting with selected members of

BGAPMEA, it was revealed that fund requirements of GAP industries are affected by the following proponents:

- Margin requirements of LC issuing banks;
- L/C encashment time taken by the banks;
- Time lag in order received and date of delivery;
- Stock of raw materials to be maintained for uninterrupted production;
- Nature and volume of overhead expenses;
- Expansion of the factory;
- Balancing, modernization and replacement of existing machineries.

The table2.3.2 (a) shows the factors affecting the needs for fund by the GAP industries as whole while table 2.3.2 (b) exhibits sub sector wise demand for funds and the proponents affecting the requirements.

Table 2.3.2 (a): Factors affecting the needs for funds by the garments accessories and packaging industries

Sl. No.	Factors affecting the needs of Funds	Frequency of Responses (No. of the Respondents-20)
01.	Margin requirements of LC issuing banks;	18
02.	LC encashment time taken by the banks;	20
03.	Time lag in order received and date of delivery;	20
04.	Stock of raw materials to be maintained for uninterrupted production;	18
05.	Nature and volume of overhead expenses.	16
06.	Time Gap between the date of opening L/C and receipt of Payment	18
07.	Time Gap between date of opening of Import L/C and unloading of Raw Materials at Factory side.	18
06.	Expansion of the factory	16
07.	Balancing , modernization and replacement of machineries	16

Table 2.3.2 (a): Factors affecting the fund requirements (Sub-Sector wise)

Sl.N0.	Name of the Industries	Types of fund	Proportion of the total requirements (in million Tk.)	Investment (in million Tk.)	Proponents affecting the requirements
01.	Button	Long term	6000	10000	i. Procurement of new machineries; ii. Replacement of old machineries; iii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	4000		i. L/C encashment time taken by the banks; ii. Time lag in order received and date of delivery; iii. Stock of raw materials to be maintained for uninterrupted production; iv. Nature and volume of overhead expenses.
02.	Chemical	Long-Term	50	100	i Construction of buildings and procurement of capital machineries; ii. Replacement of old machineries; iii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	50		i. L/C encashment time taken by the banks; ii. Time lag in order received and date of delivery; iii. Stock of raw materials to be maintained for uninterrupted production;
03.	Corrugated Carton	Long-Term	81375	162750	i. Construction factory buildings and procurement of machineries; ii. Replacement of old

					machineries; iv. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	81375		i. LC encashment time taken by the banks; ii. Time lag in order received and date of delivery; iii. Stock of raw materials to be maintained for uninterrupted production; iv. Nature and volume of overhead expenses.
04.	Elastic & Drawstring	Long-Term	18000	32700	i. Construction factory buildings and procurement of machineries; ii. Replacement of old machineries; iii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	14700		i. Margin requirements of LC issuing banks; ii. LC encashment time taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production;
05.	Embroidery	Long-Term	40	60	i. Construction factory buildings and procurement of machineries; ii. Replacement of old machineries; iii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	20		i. Margin requirements of LC issuing banks; ii. LC encashment time

					taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production;
06.	Gum Tape	Long-Term	45	90	i. Procurement of capital machineries; ii. Replacement of old machineries; iii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	45		i. Margin requirements of LC issuing banks; ii. Time lag in order received and date of delivery; iii. Stock of raw materials to be maintained for uninterrupted production;
07.	Hanger	Long-Term	144	240	i. Procurement of capital machineries; ii. Replacement of old machineries; iii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	96		i. Margin requirements of LC issuing banks; ii. LC encashment time taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production;
08.	Interlining	Long-Term	330	560	i. Procurement of capital machineries; ii. Replacement of old

					machineries; iv. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	230		i. LC encashment time taken by the banks; ii. Time lag in order received and date of delivery; iii. Stock of raw materials to be maintained for uninterrupted production; iv. Nature and volume of overhead expenses.
09.	Multi Items	Long-Term	37000	97000	i. Construction of factory buildings and procurement of machineries; ii. Replacement of old machineries; iii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	60000		i. Margin requirements of LC issuing banks; ii. LC encashment time taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production; v. Nature and volume of overhead expenses.
10.	Packaging	Long-Term	750	1200	I Construction factory buildings and procurement of machineries; ii. Replacement of old machineries; iii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	500		i. Margin requirements of LC issuing banks; ii. LC encashment time

					taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production; v. Nature and volume of overhead expenses.
11.	Padding	Long-Term	90	180	i. Procurement of equipments.
		Working Capital	90		i. Margin requirements of LC issuing banks; ii. LC encashment time taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production;
12.	Poly	Long-Term	4020	8040	i. Procurement of machineries;
		Working Capital	4020		i. Margin requirements of LC issuing banks; ii. LC encashment time taken by the banks; iii. Stock of raw materials to be maintained for uninterrupted production;
13.	PP Band	Long-Term	30	60	i. Procurement of equipments.
		Working Capital	30		i. Stock of raw materials to be maintained for uninterrupted production;
14.	Labels	Long-Term	975	1950	i. Procurement of machineries.
		Working Capital	975		i. LC encashment time taken by the banks; ii. Time lag in order received and date of delivery; iii. Stock of raw materials

					to be maintained for uninterrupted production;
15.	Quilting &Padding	Long-Term	48	80	i. Procurement of equipments.
		Working Capital	32		i. Margin requirements of LC issuing banks; ii. LC encashment time taken by the banks; iii. Time lag in order received and date of delivery;
16.	Resin	Long-Term	28	70	i. Procurement of equipments.
		Working Capital	42		i. Time lag in order received and date of delivery; ii. Stock of raw materials to be maintained for uninterrupted production;
17.	Sewing Thread	Long-Term	1440	2880	i. Construction of factory buildings and procurement of machineries; ii. Replacement of old machineries; ii. Expansion of the factory; iv. Balancing and modernization of the factory.
		Working Capital	1440		i. Margin requirements of LC issuing banks; ii. LC encashment time taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production; v. Nature and volume of overhead expenses.
18.	Screen Print	Long-Term	60	120	i. Procurement of equipments.
		Working	60		i. Margin requirements

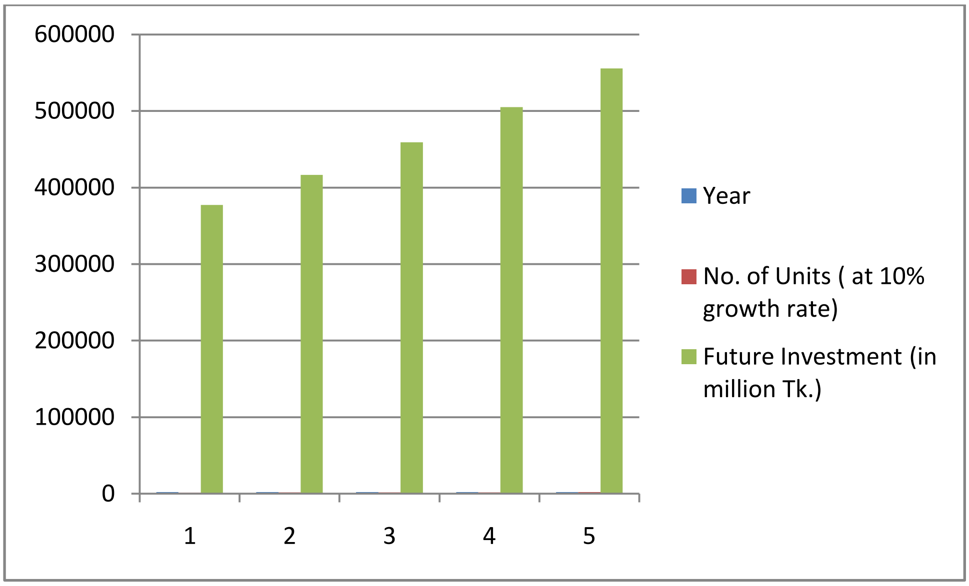
		Capital			of LC issuing banks; ii. LC encashment time taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production; v. Nature and volume of overhead expenses;
19.	Zipper	Long-Term	6000	10000	i. Construction of factory buildings ; ii. procurement of machineries; iii. Replacement of old machineries; iv. Expansion of the factory; v. Balancing and modernization of the factory.
		Working Capital	4000		i. Margin requirements of LC issuing banks; ii. LC encashment time taken by the banks; iii. Time lag in order received and date of delivery; iv. Stock of raw materials to be maintained for uninterrupted production; v. Nature and volume of overhead expenses;
Total	No of Units 1300			328130	

2.3.3 Assessment of Future Investment

Table-2.3.3: Projection of Future Investment

Year	No. of Units (at 10% growth rate)	Future Investment (in million Tk.)
2015	1361	377296
2016	1503	416632
2017	1656	459043
2018	1822	505058
2019	2004	555509

Graph



The above table shows projection of future investment in garments accessories and packaging products manufacturing units. In 2014, investment in per GAP manufacturing unit was Tk. 252 million and adding 10% for price escalation/ inflation with per unit investment, future investment in per GAP manufacturing unit have been calculated. In 2015, 1391 manufacturing units have been projected to be established with estimated investment of Tk. 377269 million while 1503 units with investment of TK. 416632 million in 2016, 1656 units with investment Tk. 459043million in 2017, 1822 units with investment of Tk. 505058 million in 2018 and 2004 units with investment Tk. 555509 million in 2019 will be established.

Chapter-3

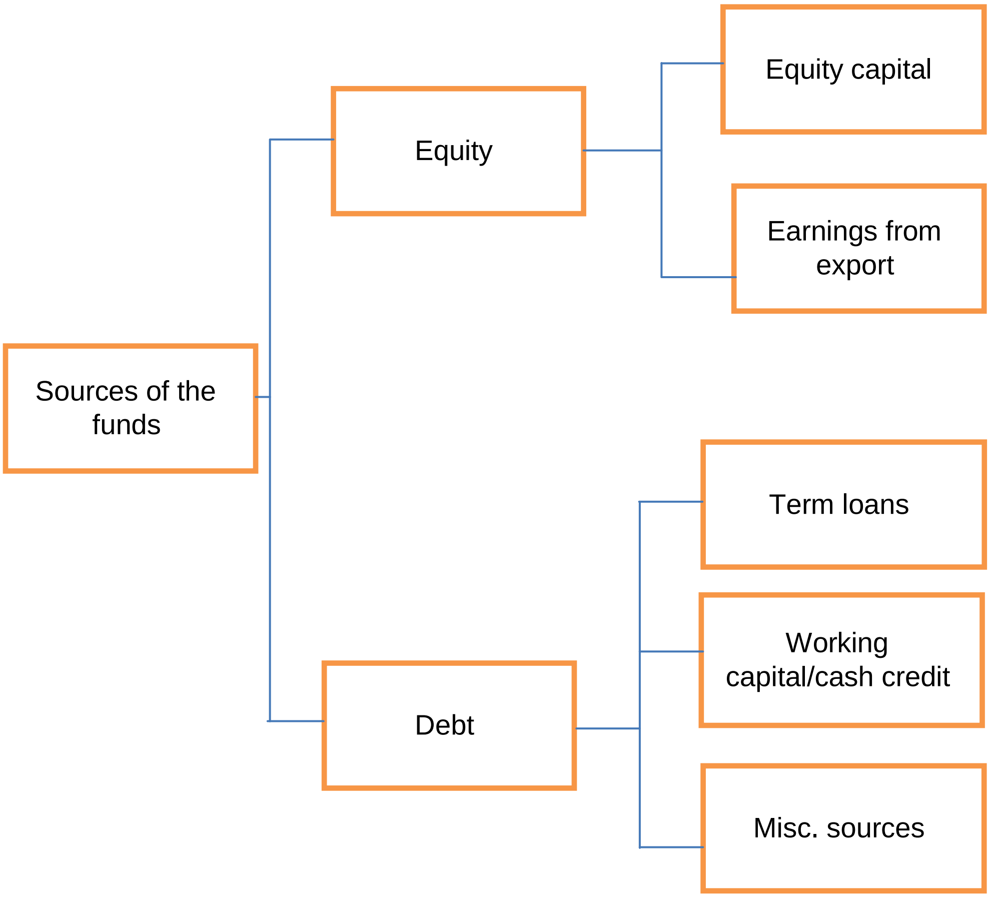
3.0 Review of Institutional Sources of Funds

3.1 Sources of Funds for GAP Industries

At the start-up stage, garments accessories and packaging industries need both long-term funds and working capital. Key factors affecting their needs for funds are:

- Preparatory Expenses (Project proposal, appraisal, etc.) Cost of land, building and capital machinery (fixed assets that the GAP units need before starting operations)
- Working capital (for stocks need to maintain by the GAP units–e.g. raw materials + overhead expenditure)
- Growth and development (e.g. extra investment for capacity expansion, replacement, modernization, etc.

Figure 3.1: Sources of Funds for GAP industries



Overall, difficulty in getting access to finance for SMEs in Bangladesh arises from demand and supply side problems. Supply and demand side problems in getting access to finance for GAP industries are:

A. Supply Side Issues

- Availability of funds to the banks;
- Lack of accessto start-up finance;
- Failure of the lien bank to encash the bill **under back to back L/C** because of insufficient balance in the exporter**s'** account;
- Lack of sufficient equity finance;
- Terms and conditions of financial institutions are not acceptable to the entrepreneurs.
- Limited experience of institutions in financing for GAP industries.

B. Demand Side Issues

- Lack of collateral;
- Lack of / limited business experience;
- Lack of information;
- Lack of management knowledge;
- Poor presentation of the business request for funding.

At present, total investment in GAP industries is about Tk. 328130 million where long term fund – working capital ratio is 48:52. Table2.3.1 exhibits the financial leverage of garments accessories and packaging products manufacturing units where long term fund and working capital are Tk. 156425 million and Tk. 171705 million respectively. At the estimated growth rate of 10%, investment in GAP industries during next five years from 2015 to 2019 will be Tk. 377269 million, Tk.416632 million, Tk. 459043 million, Tk.505058 million, Tk.555509 million respectively.

In a focus group discussion, the participants informed that the GAP industries have two types of sources of funds. These sources are:

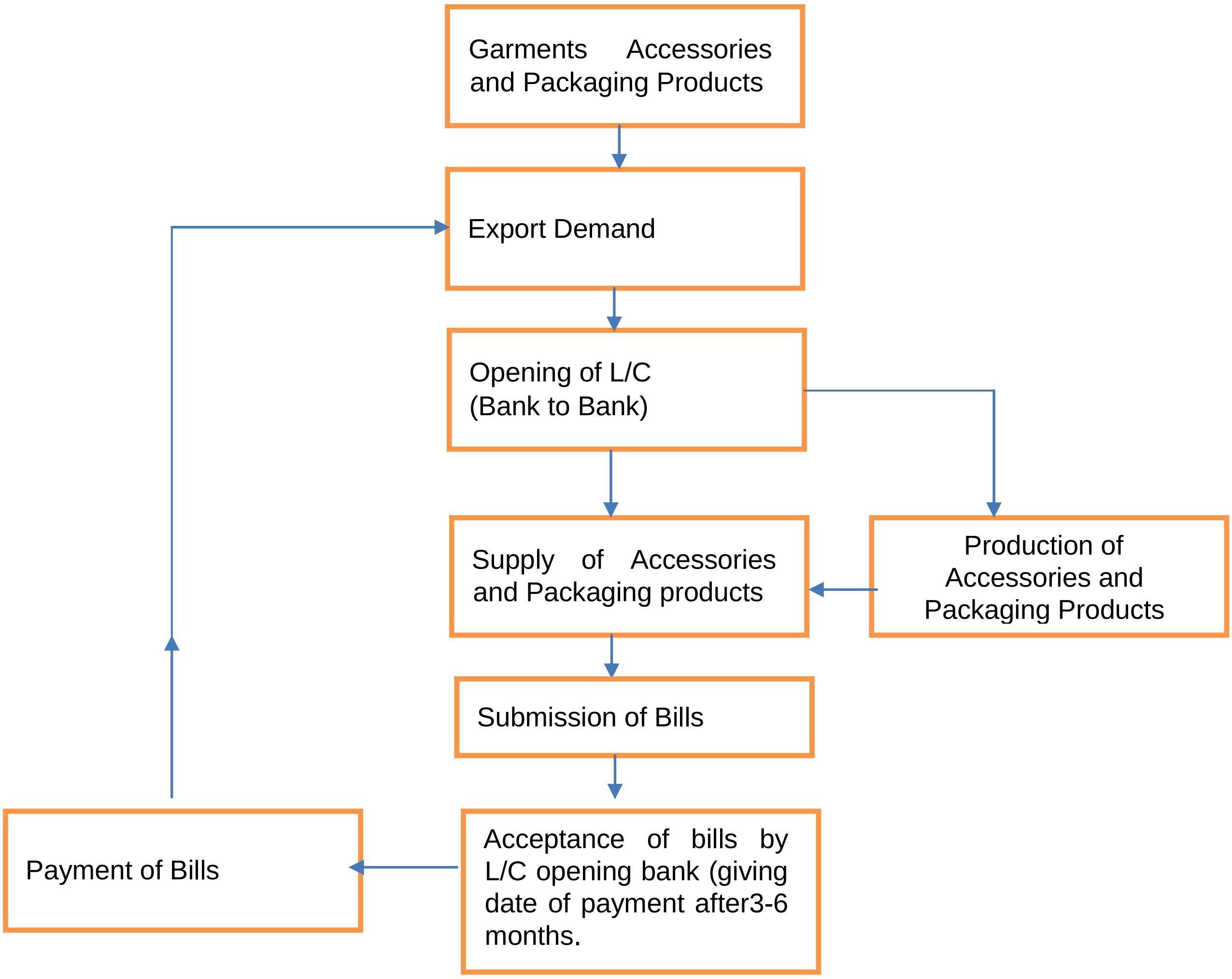
Internal Sources

i. Own capital;
ii. Retained export earnings;
iii. Depreciation provision;
iv. Sale of fixed assets;
v. Bad debt provision.

External Sources

i. Commercial banks ;
ii. Leasing companies;
iii. Specialized banks;
iv. EDF through Authorized Dealers.

Figure-3.2: Flow of Funds from Export Earnings



3.3 Terms and Conditions of Funds

3.3.1 Institutional Loans-Terms and Conditions

The followingtable-3.2.1 shows types, terms and conditions of loans from institutional sources. Rate of interest on term loans ranges 13% -15% depending upon nature of the sources. It is learnt from the discussion with the owners of GAP industries that if hidden expenses are taken into account, cost of loan will be around 15%-17%.

Table 3.3.1: Institutional sources of funds and terms and conditions

Sl. No.	Funds	Sources	Terms and Conditions
01.	Long Term / Project Loan	Commercial Banks	(a)Rate of Interest: 13 -15 percent; (b)Maturity: 5 years; (c)Repayment: Equal monthly installment.
02.	Long Term / Project Loan	Leasing Companies	(a)Rate of Interest:15-17 percent; (b)Maturity : 5-7 years; (c)Repayment: Equal monthly installment.
	Long Term / Project Loan	Specialized Banks	(a)Rate of Interest: 13 -15 percent; (b)Maturity: 5 years; (c)Repayment: Equal monthly installment.
03.	Working Capital/Cash Credit	Commercial Banks	(a)Rate of Interest: 15 -17 percent; (b)Maturity: 1 year; (c)Repayment: As per repayment schedule.
04.	Working Capital/Cash Credit	Leasing Companies	Same as commercial banks.
05.	Working Capital/Cash Credit	Bangladesh Krishi Bank/ Rajshahi Krishi Unnayan Bank/ Other Specialized Banks	(a)Rate of Interest: 15 -17 percent; (b)Maturity: 1 year; (c)Repayment: As per repayment schedule.

06.	EDF	EDF	a) Up to 31st December 2009, interest was charged by EDF@ six-month USD LIBOR, while AD charged interest @ six-month LIBOR+1 percent from the manufacturer-exporter clients borrowing for input imports. b)From 1st January 2010 onwards, EDF is charging interest on loan disbursements to ADs @ six-month USD LIBOR+1 percent while ADs are charging @ six-month LIBOR+2.5 percent on their USD loan disbursements to manufacturer-exporters.

3.3.2 Institutional Loans -Recovery Issues

Whenever a loanee fails to repay several installments of loan and if it happens for a long period of time, in such situation, the concerned loan becomes bad and doubtful. The banks/ financial institutions, on request of the client loanees and also to recover the loans, reschedule installments of repayment and timing. While considering loan rescheduling applications, the banks/ financial institutions follow the under mentioned guidelines:

- When a borrower requests to reschedule the payment of loans, the banks examine the causes as to why the loan has become non-performing. If it is found from such review that the borrower has diverted the funds elsewhere or the borrower is a habitual loan defaulter in that case, the bank shall not consider the application for loan rescheduling. Instead, the bank shall take/continue all legal steps for recovery of the loans.
- At the time of considering loan rescheduling proposal, the banks assess the borrowers' overall repayment capacity, borrowers' liability position with other *banks*, etc.
- In order to ensure repayment of installments under reschedule paradigm, banks/ financial institutions shall review the borrowers' cash flow statement, audited balance sheet, income statement and other financial statements.
- Bank officers shall ensure, if required, by spot inspection of the borrowers' company/business place, that the concerned company/business enterprise would be able to generate surplus to repay the rescheduled liability. Such inspection reports should be preserved by the banks.
- If the bank is satisfied after due diligence mentioned above that the borrower will be able to repay, the loan may be rescheduled. Otherwise, bank shall take all legal steps to realize the loan or make necessary provisions / measures to write-off.
- The rescheduling shall be for a minimum reasonable period of time.
- At the time of placing the rescheduling proposal before the Board of Directors the Bank shall apprise the Board in details, what would be implications of such loan rescheduling on the income and other areas of the bank.

3.4 Nature of Hurdles and Discriminations

3.4.1 Factors affecting the flow of funds

The consultant studied reports, circulars, notifications regarding loans from banks and also discussed the issues with the members of BGAPMEA. Both the sources gave a clear scenario of hurdles and discriminations affecting the raising of funds from institutional and non-institutional sources.
The following table 3.3.1 shows the responses regarding factors creating fund constraints to GAP industries. All of the respondents expressed that delay in receipt of export earnings through back to back LCs inhibit the growth as well as make them failure to recover loan and consequently, they become defaulters. This cause them frustrated.

Table 3.4.1: Factors affecting the flow of funds

SL No.	Sources of Funds	Factors Adversely Affecting the Flow of Funds	Frequency of Responses
1	Own capital	i. Poor resource and endowments with the owners.	20
2	Export earnings	i. Delay in receipt of payment of bill against back to back L/Cs; ii. Deferred Payment.	20
3	EDF	i. Stringent terms and conditions.	15
4	Bank loan	i. High rate of interest, Classification of loan, loan rescheduling method.	15

Table3.4.1: Factors affecting the flow of funds

The above table shows the responses regarding factors creating fund constraints to GAP industries. All of the respondents expressed that delay in receipt of export earnings through back to back LCs inhibit the growth as well as make them failure to recover loan and consequently, they become defaulters. This cause them frustrated.

3.4.2 Hurdles in the flow of funds from export earnings

(a) In a Focused Group Discussion meeting, the participants (owners of the GAP industries) informed that after supply of accessories, buyers (i.e. exporters) give acceptance on delivery challan, bills, etc. The deemed exporters then submit the above documents to their lien banks for collection of bills from the L/C opening bank following the terms and conditions of L/Cs. In many cases, the L/C opening banks delay in providing acceptance to the bills and even at time they fail to pay the bill under back to back L/C because of insufficient balance in the exporters' account.

(b) The suppliers of accessories, on receipt of the bank acceptance of deferred back to back L/C, take loan from their banks by selling the bills at high rate of interest .If the payment against these accepted bills do not come in time, the deemed exporters have to pay high rate of interest to the bills purchasing banks on the loan amount taken against the accepted bills.

(c) In case of failure in making payment of the loans taken from lien banks, the deemed exporters are treated as defaulters. In many cases, these defaulters are also treated as classified loanee.

(d) Quite often the private banks regret to purchase the bills of the deemed exporters accepted by the L/C opening banks because of their habitual delay in paying the deemed exporters' bill.

(e) Due to insufficient offshore funds, local banks refuse to pay the deemed exporters' bills in USD although the final proceeds are credited in USD against master L/Cs after 90/l20 days. Payment of the bills in local currency against back to back L/C causes financial loss to the backward linkage industries.

(f) As per current rule of Bangladesh bank, L/C for raw materials is restricted with clause of deferred payment beyond 180 days. But due to business cycle of this sector, import of raw materials and supply of finished goods to the buyers takes more than six months and after that payment is received.

(g) Due to global business crisis, many suppliers of machineries are ready to accept payment through L/C with deferred payment of 2/3 years (with or without monthly installments). But the existing rule of Bangladesh bank does not allow to open L/C with deferred payment period beyond 360 days which is not enough to build up funds from export earnings. This cause to create financial crisis for the manufacturers of GAP products.

(h) As per the reports of the representatives of BGAPMEA, the L/C opening banks quite often delay in payment of bills and in many cases these banks take 2, 4 or 6 months and in some cases, one year also to honor the bills. This unusual delay in payment by L/C opening banks pushed the deemed exporters to become defaulters of the loans taken from their lien banks. On the other hand, bank imposes high interest on loans given to the deemed exporters. Burden of such high rate of interest on loan on the one hand, and in ordinate delay in receipt of payment for the back to back L/C on the other hand, appear as unbearable burden on the GAP industries. Sometimes, these loans become classified. In such situation, classified loans are rescheduled to facilitate repayment by the defaulting deemed exporters/ GAP industries.

3.4.3 Hurdles in bank and other sources of funds

GAP industries raise funds mainly from commercial banks accepting very stringent terms and conditions of payment of high rate of interest, classification of loan in case of default, rescheduling of loan to support the loanees to recover the outstanding loans. In case of rescheduling of loan, payment of the principal amount and interest must be made. Rescheduled amount should be repaid in monthly installments. If the amount of defaulted installments is equal to the amount of 3 (monthly) installments, the loan will be classified as Bad/loss.

Hurdles in the sources of funds from banks

The following hurdles exist in the sources of funds from banks:

Vurnabilities detriment the growth and development of the GAP industries are:

(a) Very high rate of Interest;

(b) Maturity year;

(c) Strict repayment schedule;

(d) Delay in payment of bill against back to back L/C;

(e) Refusal of private banks to purchase the bills of the deemed exporters accepted by the L/C opening banks because of their habitual delay in paying the deemed exporters' bill;

(f) Rescheduling of loan of GAP industries also create hurdles. Currently cases of rescheduling are preconditioned by down payment and other conditionalities. An overview of problems &hurdles by type of loan is given in the following sub sections.

3.4.4 Hurdles in Term Loans

The loan which is repayable within a specified period of time under a prescribed repayment schedule is treated as **term loan**

(a) Down Payment of Term Loans

i. Application for first time rescheduling will be taken into consideration upon receiving cash payment of at least 15% of the overdue installments or 10% of the total outstanding amount of loan, whichever is less;
ii. Application for second time rescheduling will be considered upon receiving cash payment of minimum 30% of the overdue installments or 20% of the total outstanding amount of loan, whichever is less;
iii. Application for third time rescheduling will be considered upon receiving cash payment of minimum 50% of the overdue installments or 30% of the total outstanding amount of loan, whichever is less;

(b) Down Payment of Demand and Continuous Loan

The loan which becomes repayable on demand by the bank is treated as **Demand loan**.
The loan account in which transactions may be made within certain limit and have an expiry date for full adjustment will be treated as **continuous loan**

i. If a demand or continuous loan is converted into a term loan, first rescheduling make take place against down payment on the basis of loan amount in the following manner.

Amount of Overdue Loan	Rate of Down Payment
Up to Tk. 1.00 (one) crore	15%
Above Tk. 1.00 (one) crore and up to Tk. 5.00 (five) crore	10% (but not less than Tk. 15.00 lac)
Above Tk. 5.00 (five) crore	5% (but not less than Tk. 50.00 lac)

ii. If any continuous or demand loan is rescheduled for the second time (first time after being converted partly or wholly into term loan) and the repayment installments are fixed, the application for rescheduling of such loans shall be considered upon receiving cash payment of minimum 30% of the overdue installments or 20% of the total outstanding amount of loan, whichever is less. Similarly, for third rescheduling (second time after being converted partly or wholly into term loan) minimum 505 of the overdue installments or 30% of the total outstanding amount of loan, whichever is less, shall have to be repaid in cash.

During the rescheduled period, all required principal and interest payments must be made. Rescheduled amount should be repaid in monthly installments. If the amount of defaulted installments is equal to the amount of 3 (monthly) installments, the loan will be classified as Bad/loss.

If any contingent or any other liabilities are turned into forced loan (i.e. without any prior approval as regular loan) those too will be treated as demand loans. During the rescheduled period all required principal and interest payments must be made. Rescheduled amount should be repaid in monthly installments. If the amount of defaulted installments is equal to the amount of 3 (monthly) installments, the loan will be classified as Bad/loss.

The loan which is repayable within a specified time period under a prescribed repayment schedule is treated as term loan. In case of rescheduling of any classified fixed term loan, following time limit may be added with the expiry date/repayment date of last installment to determine the repayment schedule which will be started from the date of rescheduling. If the loan is rescheduled after the expiry date, the following time limit will be applicable from the date of rescheduling.

3.5 Hurdles and Discriminations in availing Export Development Funds (EDF) and other Funds

3.5.1 EDF was introduced in 1989 to facilitate access to financing in foreign exchange for input procurements by manufacturer-exporters. Authorized Dealer (AD) banks can borrow US dollar funds from EDF against their foreign currency loan to manufacturer-exporters for input procurements. At their option the ADs can also lend to some extent from their own foreign exchange funds for input procurements (up to fifty percent of NFCD balances, cf., para 20, chapter 13, GEET 2009).

Sl. No.	Issues	Attributes	Limitation
01.	Size of the Fund and its management	EDF loan size is USD 300 million. Bangladesh Bank is managing the fund by its Foreign Exchange Reserve and Treasury Management Department (FRTMD) at the head office of BB. Authorized Dealers (ADs) Borrow fund from the EDF and repayments are handled through head offices/principal offices of the AD banks concerned. For BGMEA, BKMEA and BTMA members , loan limit for individual unit is USD 15 million , while loan limit for individual BGAPMEA unit is USD 1 million ,	a)For BGAPMEA members , loan limit for individual unit is USD 1 million, which is insufficient.
02.	Interest rate on borrowings from EDF	b) Up to 31st December 2009, interest was charged by EDF@ six-month USD LIBOR, while AD charged interest @ six-month LIBOR+1 percent from the manufacturer-exporter clients borrowing for input imports. b)From 1st January 2010 onwards, EDF is charging interest on loan disbursements to ADs @ six-month USD LIBOR+1	

		percent while ADs are charging @ six-month LIBOR+2.5 percent on their USD loan disbursements to manufacturer-exporters.	
03.	Tenor of EDF loans	EDF loans from BB are repayable by the ADs upon receipt of proceeds of the relative exports (except in case of loans for bulk import of cotton and other textile fibre by BTMA member mills against past export performance); in all cases within 180 days from dates of disbursement, extendable by BB up to 270 days upon application to BB explaining the necessity of longer period for repatriation of export proceeds.	
04.	Eligibility for EDF loans	a) Input imports by manufacturer-exporters against which an AD seeks EDF loan must be in full compliance with the value addition criterion and other requirements of the governments import policy order (IPO) in force and of foreign exchange regulations and instructions laid down in the GEET 2009 and subsequent circulars of BB. b)Input imports by manufacturer-exporter defaulting in repatriation of export proceeds within the statutory period (within 120 days from date of shipment or such extension as permitted by BB) will not be eligible for financing from the EDF besides other usual regulatory penalties. c) To qualify for availing the EDF, the deemed exporters must receive the payment of their exported commodities against back to back L/C in US Dollars. But usually, the payments for back to back L/Cs are made by L/C opening banks in local currency equivalent to US$. This prohibits the deemed exporters to avail EDF facilities	

Chapter-4

4.0 Review of Regulatory and Policy Issues for Financing the GAP Industries

4.1 Identifying the Barriers affecting the GAP Industries

Bangladesh has a target to export RMG valued at US$ 50 billion by the year 2021. On average, contribution of garment accessories and packaging to RMG export earnings is about 16%. Under this assumption, export earnings from Garments Accessories and Packaging sector have been estimated to arrive at $8.0 billion during 2021. If the packaging and accessories could be exported directly together with deemed exports the figure may even assume much higher figure and may stand as a parallel industry sector with RMG in terms of earning.

In order to provide necessary development supports underpinning the entrepreneurs of GAP sector, appropriate policy packages should be ensured in consistent with the entrepreneurial stages of development such as, stimulatory, support and sustenance. Embedding these attributes in policy agenda, the government should frame perspective action plan to support GAP enterprises with package of financial and non-financial supports. Currently, GAP industries are encountered by the problems like- receipt of payment against back to back L/C, deferred payment, rescheduling of classified loan, delay in acceptance of the L/C documents, etc.
The Following figure shows the sources of funds and barriers to the flow of funds to GAP industries:

Sl. No.	Sources of finance	Barriers to the flow of funds	Existing rules /practice
(a) Internal Sources			
1.	Revenue from export earnings	Delay in payment of bill against back to back L/C. (a)In many cases, the L/C opening bank fails to pay the bill under back to back L/C because of insufficient balance in the exporters' account. (b) Refusal of private banks to purchase deemed exporters' bill whenever they need funds. (c)Payment of deemed export proceeds in local currency.	After supply of accessories, the L/C opening buyers (i.e. exporters) give acceptance on delivery challan, bill etc. The deemed exporters then submit the above documents to their lien banks. Usually the L/C opening bank, on receipt of delivery challan and other papers accord its acceptance and inform the lien bank (bill negotiating bank) that it would make payment after 90/120 days as per the terms and conditions of the L/C. There are instances that the L/C opening bank delay in providing its acceptance of the documents and while in other cases the L/C opening bank, after providing acceptance, delay in making payment due to shortage of funds in the Accounts of the concerned exporting RMG factory.

			b) In ideal situation, the suppliers of accessories, on receipt of the bank acceptance of deferred back to back L/C, take loan from their banks by selling the bills at high rate of interest .If the payment against these accepted bills do not come in time, the deemed exporters have to pay high rate of interest to the bills purchasing bank on the loan amount taken against the accepted bills. (c)In many cases, situations become very unfavorable for the GAP units, where the lien banks regret to purchase the bills of deemed exporters accepted by the L/C opening banks because of their habitual delay in paying the deemed exporters' bill. (d) Another undesirable practice of the L/C opening banks to pay in local currency, although the L/C has been opened in US Dollar and the L/C opening banks receive payment for master L/C in US Dollar. As a result of this practice, the GAP units fail to avail EDF fund as they are unable to show their export earnings in foreign currency.
2.	Owners' Equity	(a) Insufficient funds generated from internal sources.	-

(b) External Sources

Sl. No.	Sources of Finance	Barriers to the flow of funds	Existing Rules & Practices
1.	Bank Loan	(a) High rate of interest (b) Collateral securities (c) Stringent terms and conditions of bank loan	a) For term loan, bank charges interest from 13% to 15%. For working capital, it is around15% and above. If hidden charges are taken into account, rate of interest will be exceeding 17%. b) For term loan, Banks demand collateral securities which are additional to the mortgaged property. **c) Policy on loan classification and provisioning.** **Basis for loan classification:** Any Continuous Loans, if not repaid/renewed within the pre-determined expiry date for repayment, is treated as outstanding overdue from the following day of the expiry date. This loan will be classified as sub-standard if it remains past due/overdue for 6 months or beyond but less than 9 months, as \`Doubtful' if for 9 months or beyond but less than 12 months and as \`Bad-Debt' if for 12months or beyond. Any Demand Loan, if not repaid/rescheduled within the pre-determined expiry date for repayment, is treated as past due/overdue from the following day of the expiry date. This Loan will be classified as Sub-standard if it remains past due/overdue for 6 months or beyond but not over 9 months from the date of claim by the bank or from the date of creation of the forced loan; likewise the loan will be classified as "Doubtful' and Bad/loss if remains past due/overdue for 9 months or beyond but not over 12 months and for 12 months and beyond respectively. In case any installment(s) or part of installment(s) of a Fixed Term Loan is not repaid within the due date, the amount of unpaid installment(s) will be

			termed as `defaulted installment'-  In case of Fixed Term Loans, which are repayable within maximum five years of time: –  • If the amount of `defaulted installment' is equal to or more than the amount of installment(s) due within 6 months, the entire loan will be classified as "Sub-standard". • If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 12 months, the entire loan will be classified as "Doubtful. • If the amount of 'defaulted installment' is equal to or more than the amount of installment(s) due within 18 months, the entire loan will be classified as "Bad - Loss." In case of Fixed Term Loans, which are repayable in more than five years of time: – • If the amount of `defaulted installment' is equal to or more than the amount of installment(s) due within 12 months, the entire loan will be classified as 'Sub-standard.' • If the amount of `defaulted installment 'is equal to or more than the amount of installment(s) due within 18 months, the entire loan will be classified as 'Doubtful'. • If the amount of 'defaulted installment 'is equal to or more than the amount of installment(s) due within 24 months, the entire loan will be classified as 'Bad-Debt'.
2.	Export Development Fund(EDF)	(a) For GAP industries, EDF loan limit for individual unit is USD 1 million which is not sufficient.	a) Up to 31st December 2009, interest was charged by EDF@ six-month USD LIBOR, while AD charged interest @ six-month LIBOR+1 percent from the manufacturer-

			exporter clients borrowing for input imports. b) From 1st January 2010 onwards, EDF is charging interest on loan disbursements to ADs @ six-month USD LIBOR+1 percent while ADs are charging @ six-month LIBOR+2.5 percent on their USD loan disbursements to manufacturer-exporters.

4.2 Formulation of Innovative Policy Issues and Regulations for helping reducing cost, raising productivity and improving Competitiveness of the GAP sector.

RMG sector is the only multi-billion manufacturing and export industry in Bangladesh. Garments accessories and packaging industries, as the running mate of RMG Sector, are growing at the rate of 23%. This impressive growth does not indicate that the sector is growing smoothly. Many constraints hinder the growth and development of garments accessories and packaging manufacturing units. Efforts to remove these constraints will obviously foster this sector.

As mentioned in the previous chapter that the GAP sector shows an outstanding performance where their contribution in total RMG export is around 18%- 23%.With this export performance , the sector is striving for better condition and policy support to remove constraints to get export earnings and funds from financial institutions at lower cost. The following analysis gives an overview how policy measures and innovative policy issues can help to reduce cost, raise productivity, and improve competitiveness.

4.2.1 Removal of the Constraints adversely affecting the Revenue from Export Earnings

In order to remove the constraints, which are adversely affecting the export earnings of the GAP manufacturing units, the following policy decisions are recommended:

(a) One of the most frequently experienced constraints is the non-payment or delayment in payment by the L/C opening banks. In such situation, Bangladesh Bank should give strict instructions to the L/C opening bank to comply the terms and conditions of L/C issued by them. The proposed instructions should cover the issues such as providing bank acceptance in time, making payment in time etc.

(b) The suppliers of accessories, in many cases, on receipt of bank acceptance take loan from their banks by selling bills at high rate of interest. Due to delay in getting the payment from the garments exporters, the deemed exporters fail to repay the loan taken against the accepted bills for which they have to pay high rate of interest. Keeping the issue in strict contingence, Bangladesh bank should either issue order upon the lien banks to pay the deemed exporters' bill following the terms and conditions of L/C or Bangladesh Bank should issue a regulatory order to the L/C opening bank to make payment of deemed exporters bill as per terms and conditions of L/C and in case of delay in payment, pay interest at the same rate at which the lien banks purchase documents or exempt the interest due to delay caused by the banks in paying the accepted bills.

(c) As mentioned earlier that Bangladesh Bank should advise the L/C opening bank to make payment as per terms and conditions of L/C or exempt interest due to delay by L/C opening banks / lien banks. Such type of action will create confidence of the private banks and will be motivated to purchase bills of the deemed exporters.

4.2.2 Actions to Remove Constraints affecting Flow of Funds from Financial Institutions

The composition of financial packages of Garment Accessories and packaging industries include, among others, term loan, working capital and EDF fund. These sources involve long list of conditionalities which are not suitable for these manufacturing units. In order to remove the constraints to finance from banks, the following measures may be taken which will help to reduce costs, raising productivity and improving competitiveness of the GAP sector.

(a) **For terms loan**, rate of interest ranges from 12% to 14% if hidden expenses are taken into account, cost of loan will be around 15% to 17% which, by any definition, is too high and inhibits of the growth of the industrial sector. In such situation, Bangladesh bank/ Govt. may formulate policy packages to reduce the rate of interest on term loans as well as, considering these manufacturing units as SMES, may create fund/ credit line at lower cost and easy terms and conditions.

(b) Interest rate on working capital is about 15-17%.Bangladesh bank may advise the commercial banks to arrange working capital for garment accessories and packaging units at lower rate of interest with soft terms and conditions.

4.2.3 Other Policy issues

(a) Import of raw materials of the GAP sector is restricted with the clause of deferred payment beyond 180 days. But due to business cycle of this sector, import of raw materials and supply of finished goods to the buyers take more than six months and after that payment is received. In that case, clause of deferred payment may be relaxed until payment is received from the buyers.

(b) Machineries are imported with condition of deferred payment within 360 days but due to global business crisis and delay in payment of bills by the deemed exporters, GAP industries face problems to manage funds for payment of suppliers' bill. In such situation, Bangladesh Bank with consent from the suppliers may allow payment through opening of L/C with deferred payment of 4/5 years (with or without monthly installments).

Chapter-5

5.0 Access to Finance by GAP Units

5.1 Designing Financial Product for GAP industries

As discussed in chapter – 2 (Sec.2.2) Bangladesh is aiming at exporting RMG for US$ 50 billion by the year 2021.Investment in GAP industries during next five years from 2015 to 2019 will be Tk. 377296 million, Tk.416632 million, Tk. 459043 million, Tk.505058 million, Tk.555509 million respectively. Funds for these projected investments will be managed from owned capital, retained export earnings and financial institutions. In managing financial resources, various obstacles discussed in the earlier sections, are hindering the investment in GAP sector in such situation, following strategy may be adopted to channelize funds for garments accessories and packaging industries:

(a) Managing funds from Retained Earnings;
(b) Managing funds from Institutional Sources;
(c) Innovative Financial products for the Garments Accessories and Packaging Manufacturers;
(d) Cash Incentives.

(a)Managing Funds from Retained Export Earnings

Although retained export earnings are one of the best sources of funds for garments accessories and packaging industries but flow of funds from export earnings are hindered by the causes as discussed in section 3.3.2. In order to remove the obstacles, the following remedial measures have been suggested:

A number of remedial measures have been suggested below to remove the obstacles:

i. Bangladesh Bank should advise L/C opening hanks (i.e. banks of RMG exporters) to pay the deemed exporters' bills as per terms and conditions of the Back to back L/C. This will help to streamline the funds for GAP industries;

ii. Suppliers of accessories, in many cases, on receipt of bank acceptance, take loan by selling bills to the lien banks. But quite often the lien banks regret to purchase the bills of the deemed exporters accepted by the L/C opening banks because of their habitual delay in paying the deemed exporters' bill. In such case, Bangladesh Bank may advise the lien banks to accept the bills and L/C documents duly accepted by the L/C opening banks. This type of effort will motivate the lien banks to purchase bills of the deemed exporters and will facilitate flow of funds for the GAP industries.

iii. Showing the cause of insufficient offshore funds, the L/C opening banks refuse to pay the deemed exporters' bills in USD although the final proceeds are credited in USD against master L/C. In this regard, Bangladesh Bank should issue regulatory instructions to L/C opening banks to pay the deemed exporters' bills in USD.

(b)Funds from Institutional Sources

i. Rate of interest on term loan ranges from 12% to 14%. If the hidden expenses are taken into account, cost of loan will increase to 15% to 17% which is excessive and inhibits of the growth of the sector. In such situation, Bangladesh bank/ Govt. may formulate policy guidelines to reduce the rate of interest on term loans as well as considering these industries as SMES may create fund/ credit line at lower cost and easy terms and conditions.

ii. Interest rate on working capital is about 15-17%. This rate is also too high for export-oriented GAP industry sector. Bangladesh bank is recommended to issue regulatory instructions to the commercial banks to arrange working capital for GAP industries at lower rate of interest with soft terms and conditions.

(c) Innovative Financial Products for the GAP industries

I. The National Loan Guarantee Scheme (NLGS)

The Govt. may introduce National Loan Guarantee Scheme (NLGS), which will be based on government guarantees for unsecured borrowing by banks, enabling them to borrow at a cheaper rate. Participating banks will pass on the entire benefit that they will receive from the guarantees to the GAP manufacturers at cheaper rate.

ii. Enterprise Finance Guarantee (EFG)

EFG is a loan guarantee scheme to facilitate additional lending to viable GAP manufacturers lacking the security or proven track record for a commercial loan. Government may introduce EFG scheme which will provide the lender with a 75% guarantee for each individual facility.

iii. Export Development Fund (EDF)

EDF loan fund size is USD 300 million. Bangladesh Bank is managing the fund by its Foreign Exchange Reserve and Treasury Management Department (FRTMD) at the Head Office of Bangladesh Bank. For BGMEA and MKMEA and BTMA members loan limit is USD 20 million while loan limit for individual BGAPMEA unit is USD 2 million. Considering the imperatives of EDF, this facilities may be extended for long term project financing (for financing of construction works, procurement of machineries, etc.) .

Chapter - 6

6.0 Recommendations

RMG sector is the largest multi-billion dollar export-oriented manufacturing industries in Bangladesh. Garments accessories and packaging industries are growing at the rate of 23%. But many constraints hinder the growth and development of garments accessories and packaging industries. Efforts should be taken to remove these constraints. As mentioned in the previous chapters that the GAP sector shows an outstanding performance with its contribution to total RMG export ranging between 18%- 23%. With this export performance, the sector is striving for better condition and policy support to remove constraints. The consultants recommend the following regulatory / policy actions to remove the constraints hindering the growth and development of the GAP manufacturing units.

6.1 Recommendations to Remove the Constraints inhibiting the Flow of Revenue Earnings from Exports.

(a) In order to facilitate the receipt of early payment of deemed exporters' bills through negotiation of back to back L/C, Bangladesh Bank should advise the lien banks to purchase the same duly endorsed by the L/C opening banks.

(b) The suppliers of accessories take loans from their banks by selling bills at high rate of interest. Due to delay in getting the payment from garments exporters, the deemed exporters fail to repay the loan taken against the accepted bills for which they have to pay high rate of interest. In view of this, Bangladesh bank is recommended to issue necessary instructions to the L/C opening banks to pay the deemed exporters' bill as per terms and conditions of L/C.

(c) In making the payment against back to back L/C, the L/C opening banks not only delay in payment but also they make payment in local currency although they receive payment against master L/C in US Dollar. This results in a financial loss for the backward linkage industries due to payment of bill in local currency. For this, Bangladesh Bank may issue regulatory order to pay deemed exporters' bill in USD/ foreign currencies.

(d) In many cases, GAP manufacturers supply accessories and packaging products against work order of the direct exporters and get LCs later on. In many cases, they are deprived of getting the LCs from the direct exporters. Even if they (GAP manufacturers) get LCs, sometimes they don't get payment as the date of maturity is not given by the opening bank for silly discrepancies. Under this circumstance, there should be an arbitrary body under the supervision of Bangladesh Bank which will help the deemed exporters to get the payments.

6.2 Recommendations to Remove Constraints inhibiting the Flow of Funds from Financial Institutions

Garments Accessories and Packaging Manufacturers raise funds from different sources with stringent terms and conditions, which are very unfavorable for this subsector. In order to remove the constraints hindering the free flow of funds from banks the following measures may be taken which will help to reduce costs, raising productivity and improve Competitiveness of the GAP products manufacturing units.

(a) The existing rate of interest on term loan ranges from 12% to 14% and if hidden expenses are taken into account, cost of loan will be 15% to 17% which is excessive and inhibits of the growth of the subsector. In such situation, Bangladesh bank/ Govt. may formulate and adopt policy measures to reduce the rate of interest on term loans.

(b) In view of promising role in export earnings, the units under the GAP sector may be given financial support on easy terms considering them as SME industries.

(c) For working capital, Bangladesh bank may issue regulatory instructions to the commercial banks to arrange working capital for GAP manufacturers at lower rate of interest with soft terms and conditions

(d) Deemed exporters should be covered under given cash incentives scheme of the Govt. for export target achieved by them.

(e) Export Development Fund (EDF)

i. EDF loan fund size is USD 300 million. Bangladesh Bank is managing the fund by its Foreign Exchange Reserve and Treasury Management Department (FRTMD) at the Head Office of Bangladesh Bank. The loan is for the BGMEA, BKMEA and BTMA members is USD 20 million while loan limit for BGAPMEA unit is USD 2 million, considering the imperatives of EDF, this facilities may be extended for long term project financing (for financing of construction works, procurement of machineries, etc.) .

ii. To match with the proceeds realization time, repayment period of loan for raw materials may be extended up to 1 year .

(f) Innovative Financial Products for the GAP industries

i. The National Loan Guarantee Scheme (NLGS) : The Govt. may introduce National Loan Guarantee Scheme (NLGS) which will be based on government guarantees for unsecured borrowing by banks, enabling them to borrow at a cheaper rate. Participating banks will pass on the entire benefit that they will receive from the guarantees to the GAP manufacturers at cheaper rate.

ii. Enterprise Finance Guarantee (EFG): EFG is a loan guarantee scheme to facilitate additional lending to viable GAP manufacturers lacking the security or proven track record for a commercial loan. Government may introduce EFG scheme for GAP units with 75% guarantee for each individual facility.

(g) Other Recommendations:

i. Currently L/C for raw materials is restricted with clause of deferred payment beyond 180 days. But due to business cycle of this sector, import of raw materials and supply of finished goods to the buyers takes more than six months and after that payment is received. In view of this, the Bangladesh Bank is recommended to relax the clause of deferred payment.

ii. Due to global business crisis, many suppliers of machineries are ready to accept payment through L/C with deferred payment of 4/5 years (with or without monthly installments). But the existing rule of Bangladesh bank does not allow to open L/C with deferred payment period beyond 360 days which is not enough to build up funds from export earnings. In such situation, Bangladesh Bank, in consultation with the suppliers of machineries, may consider the deferred payment for a reasonable time.

iii. Currently Garments Accessories and Packaging industries are paying corporate tax at the rate of 25% which is recommended to be reduced to 10%.

iv. Garments accessories and packaging (GAP) industries are paying tax at source @0.80. Considering the affordability of the GAP industries, such tax may be reduced to 0.60 as was earlier.

v. Foreign currency investment plan should also contain the provision of using foreign investment fund for replenishing the existing loan of GAP industries in addition to finance new project loan and BMRE project.

vi. Currently, Bangladesh Bank provide long term foreign currency loan for the new projects. Considering the needs for foreign currency loans by the existing industries, this credit line to be extended to these industries.

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