

Trends and Challenges in MSME Development and Access to Finance in Sri Lanka

Lessons from Asia SME Monitor 2021

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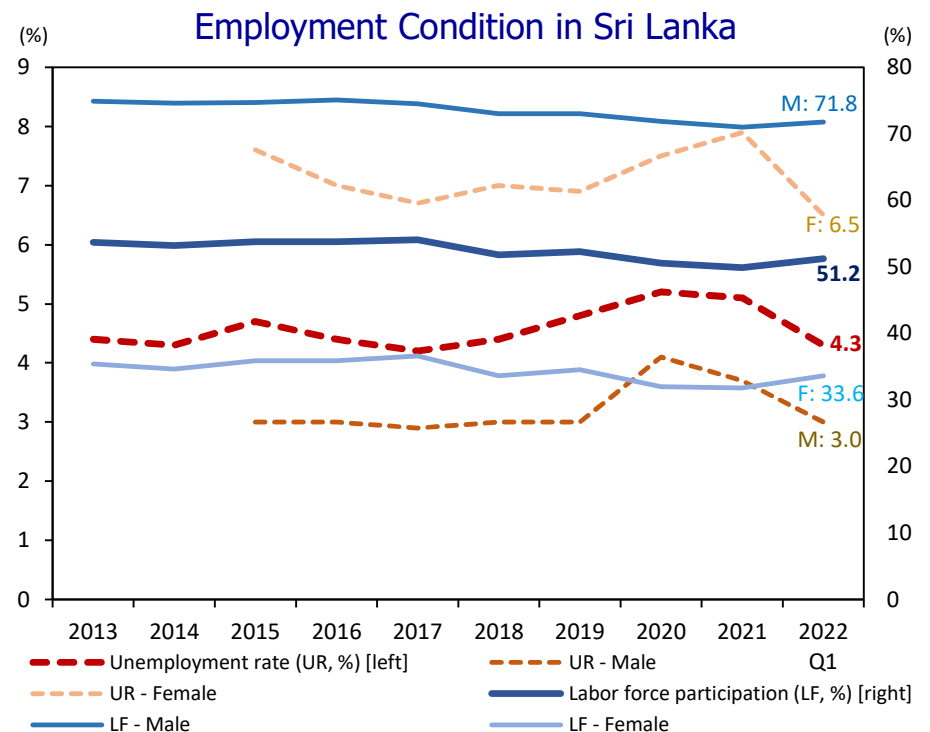
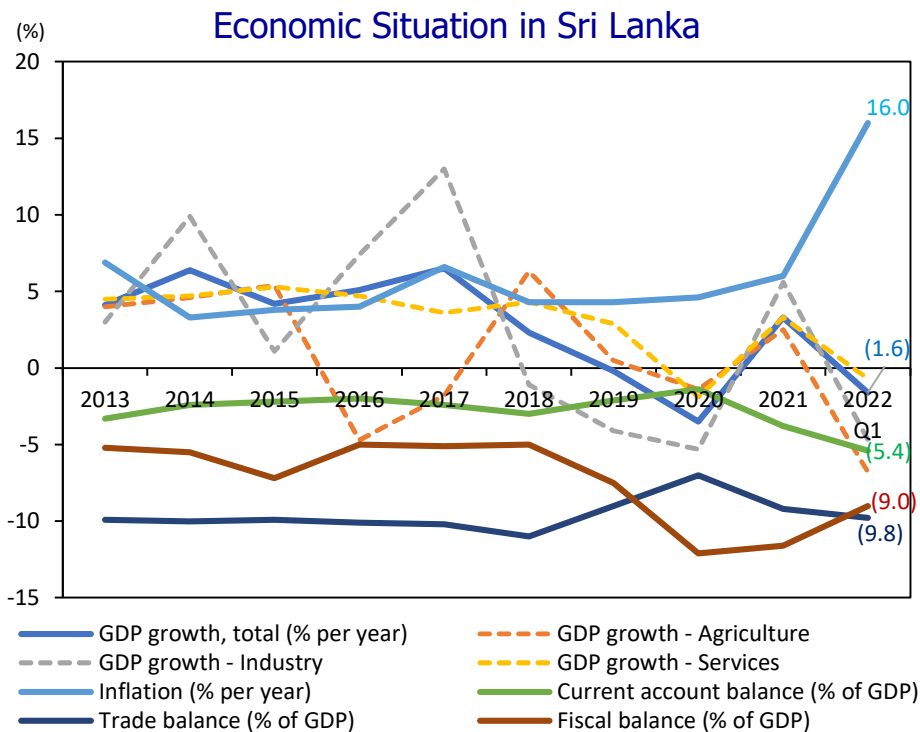
Economic Research and Regional Cooperation Department

Asian Development Bank

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Economic growth in Sri Lanka has fallen due to a series of shocks since 2016. The BOP crisis again hit the economy recovering from the pandemic. The unemployment remains high in female.



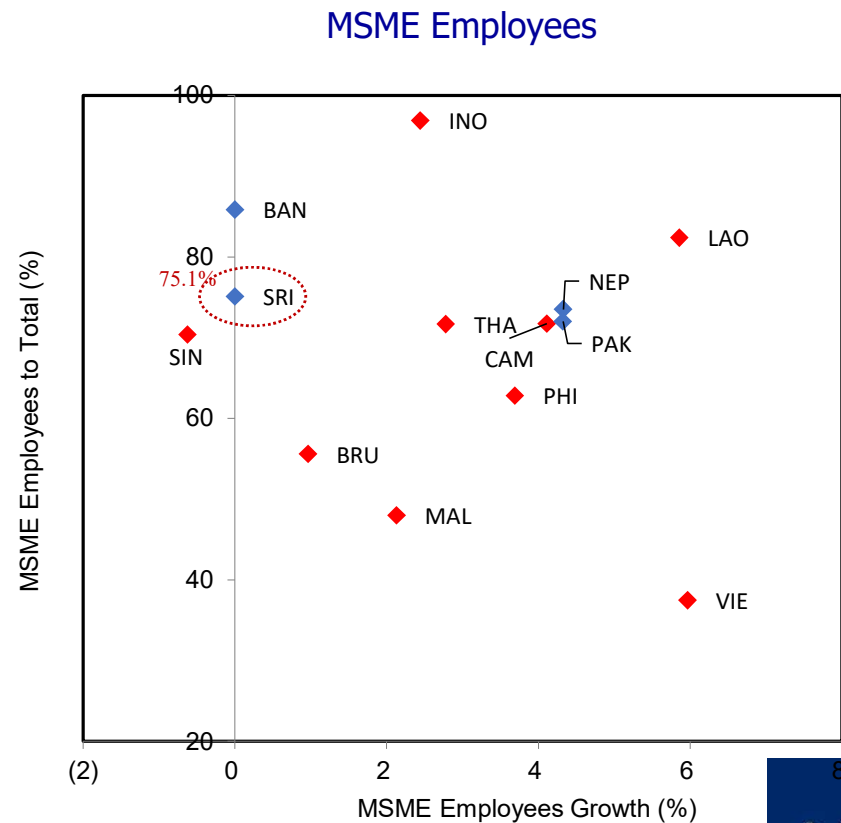
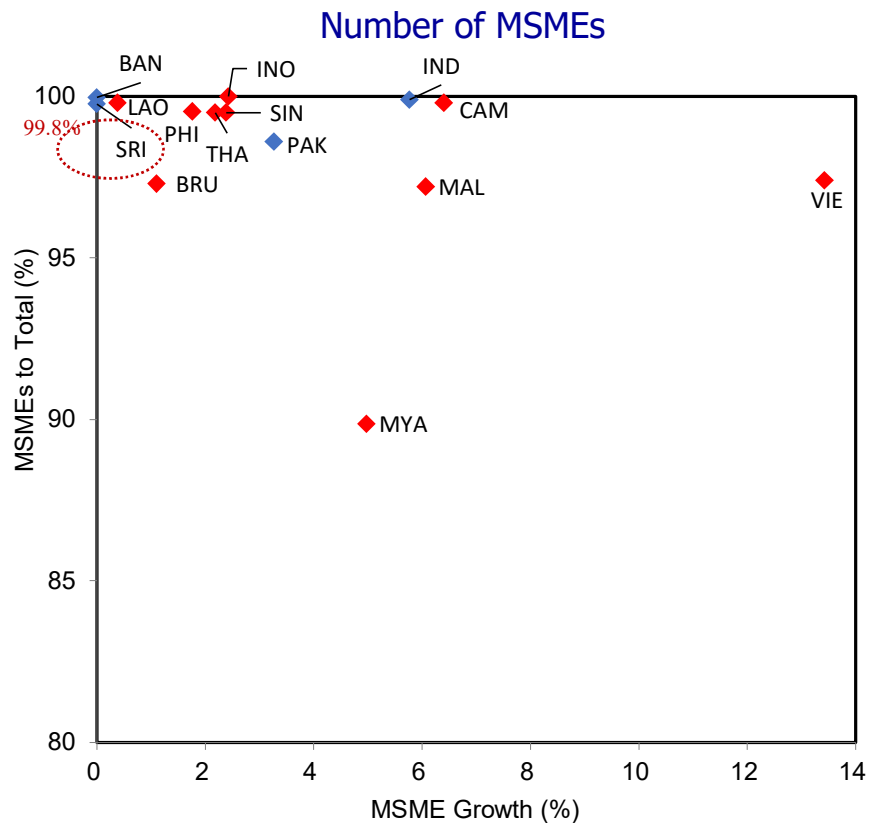
GDP = gross domestic product.

Notes: Inflation, as measured by the consumer price index, reflects the annual percentage change in the cost to the average consumer of acquiring a basket of goods and services. The current account balance is the sum of the balance of trade for merchandise, net trade in services and factor income, and net transfers; the values are divided by GDP at current prices in US dollars. Trade balance is the difference between merchandise exports and merchandise imports; the difference is divided by GDP at current prices. Fiscal balance indicates the difference between central government revenues and expenditures; the difference is computed as a share of GDP at current prices.

Source: Recomposed from ADB Key Indicators, Asian Development Outlook, Basic Statistics, various editions.



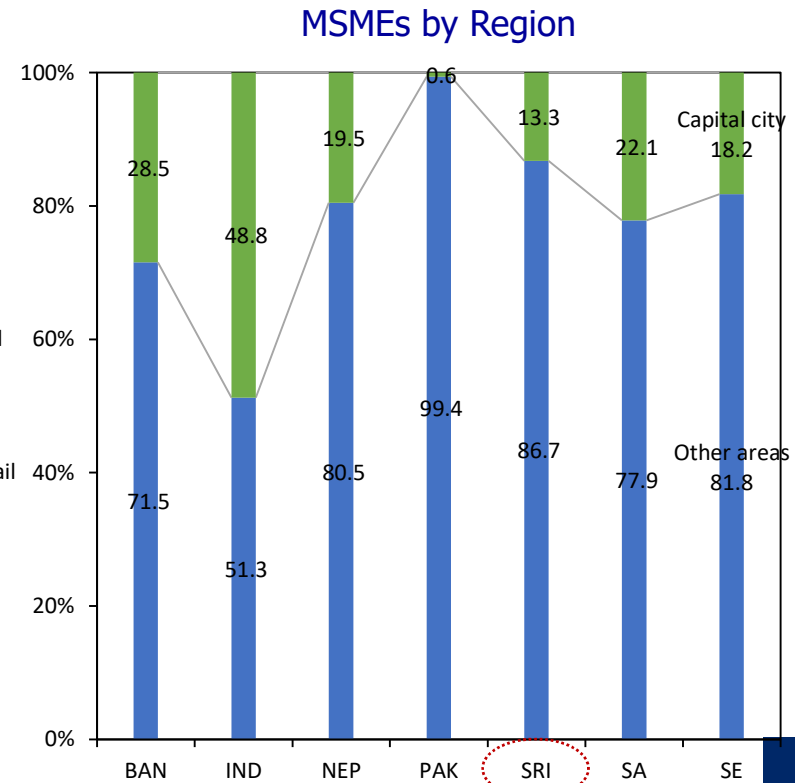
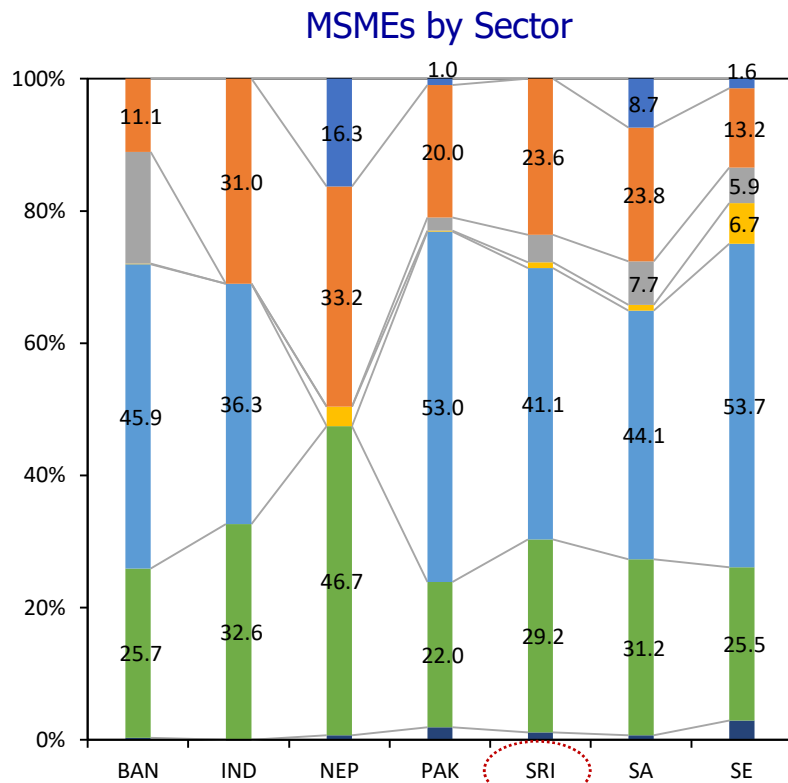
MSMEs are a key driver of the economy, creating quality jobs and innovation. Revitalizing MSMEs is critical to building a resilient economic recovery.



BAN = Bangladesh; BRU = Brunei Darussalam; CAM = Cambodia; IND = India; INO = Indonesia; LAO = Lao PDR; MAL = Malaysia; MSME = micro, small, and medium-sized enterprise; MYA = Myanmar; NEP = Nepal; PAK = Pakistan; PHI = Philippines; SIN = Singapore; SRI = Sri Lanka; THA = Thailand; VIE = Viet Nam.
 Notes: Data refer to the latest available data until 2020. For Sri Lanka, data in 2013.
 Source: ADB Asia SME Monitor 2021 database.



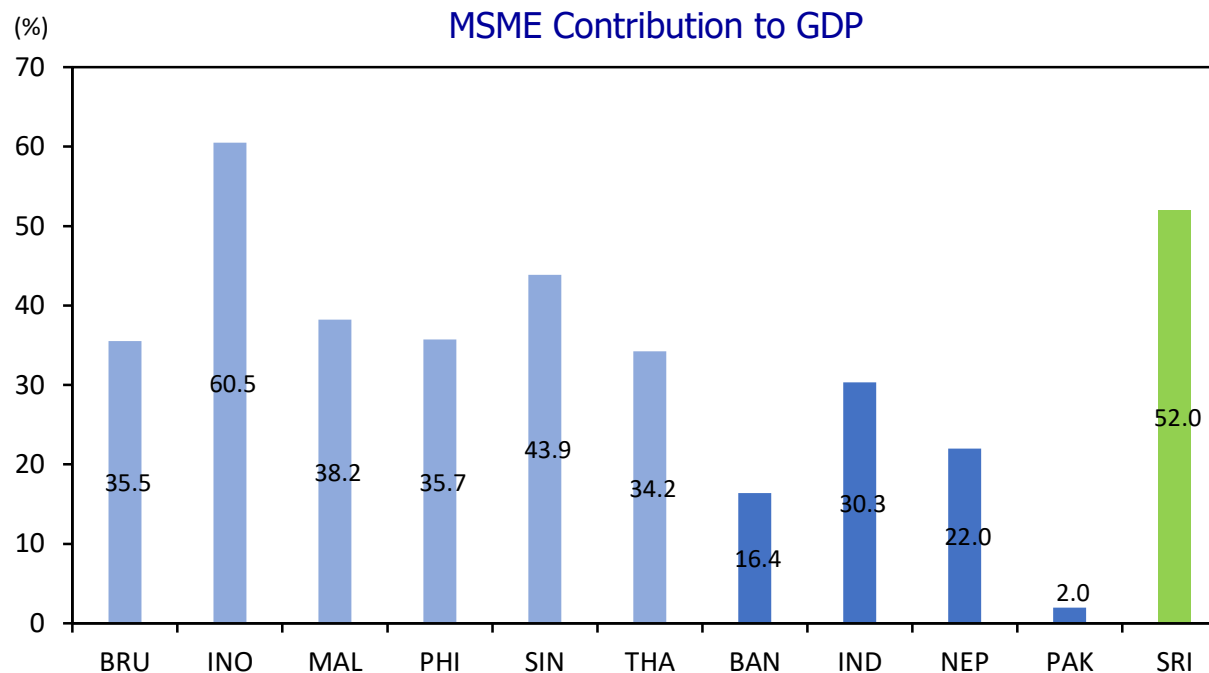
MSMEs largely supply domestic markets, with many engaged in services and informal. Fostering innovative rural-based businesses is key to strengthen MSME growth and dynamics.



BAN = Bangladesh; IND = India; MSME = micro, small, and medium-sized enterprise; NEP = Nepal; PAK = Pakistan; SA = South Asia; SE = Southeast Asia; SRI = Sri Lanka.
 Notes: Data refer to the latest available data until 2020. For Sri Lanka, data in 2013. SA and SE refer to average of reporting countries.
 Source: ADB Asia SME Monitor 2021 database.



MSMEs contributed to more than half of GDP in Sri Lanka. Formalizing MSMEs and connecting international markets would boost national productivity further.



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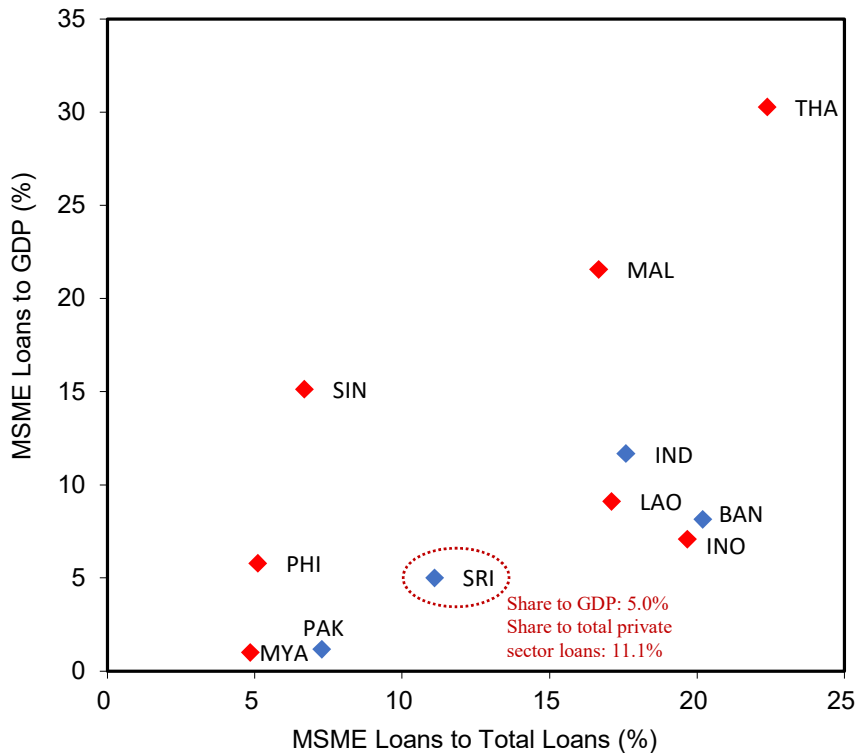
Notes: Data refer to the latest available data. 2006 for PHI; 2018 for BRU; 2019 for INO, IND, NEP; 2020 for MAL, THA, BAN, PAK; 2021 for SIN. For Sri Lanka, data from the National SME Policy 2015.

Source: ADB Asia SME Monitor 2021 database.

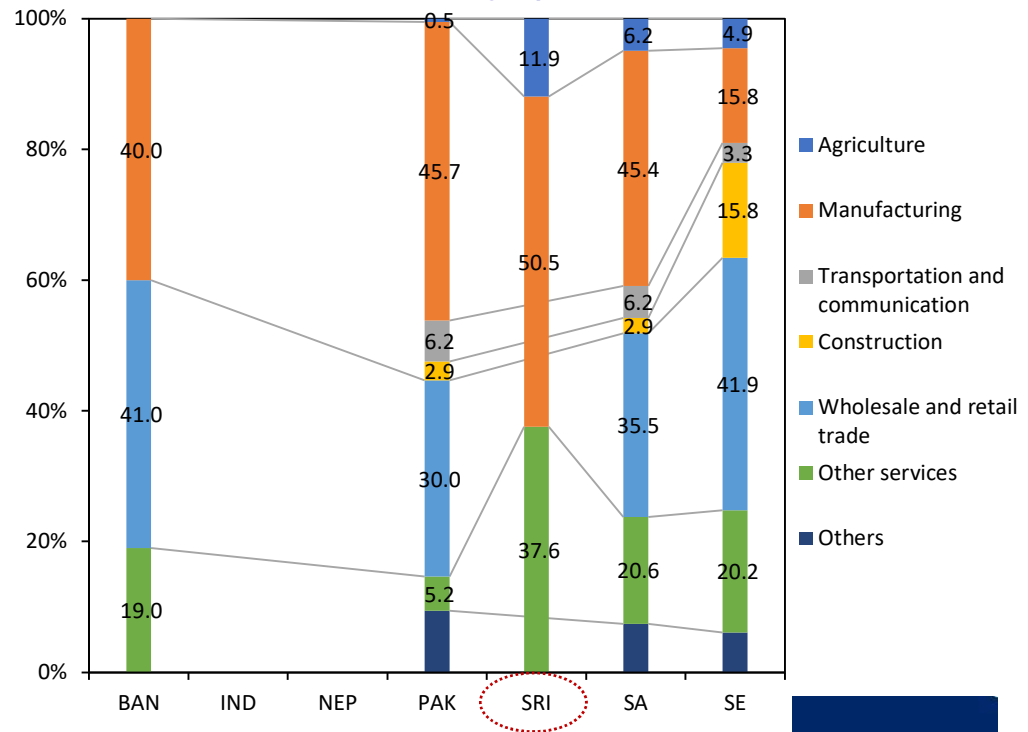


MSME credit market remains small. The majority went to the manufacturing.

MSME Loans Outstanding, 2020



MSME Loans Outstanding by Sector, 2020



BAN = Bangladesh; IND = India; INO = Indonesia; LAO = Lao PDR; MAL = Malaysia; MSME = micro, small, and medium-sized enterprise; MYA = Myanmar; PAK = Pakistan; PHI = Philippines; SA = South Asia; SE = Southeast Asia; SIN = Singapore; SRI = Sri Lanka; THA = Thailand.
Data refer to the latest available data until 2020. For Sri Lanka, data in 2020. SA and SE refer to average of reporting countries.
Source: ADB Asia SME Monitor 2021 database.



The government offered financial assistance to MSMEs to supplement their financing needs. They have been actively used as emergency assistance tools to MSMEs hurt by the pandemic.

Assistance and Infrastructure for MSME Access to Finance

Item	Bank Credit						Public Finance			Emergency Assistance (Response to COVID-19)					
	Refinancing facilities to banks	Credit guarantees/ credit risk sharing	Mandatory lending to MSMEs	Interest rate subsidy	Credit bureaus/ credit information system	Secured transaction legal system	Specialized bank for MSMEs	Direct lending/ special funds/ soft loans	Focused groups financing	Liquidity support for financial institutions/capital injection	Debt restructuring/ deferral of debt payments	Relaxed lending conditions/ interest rate reduction	New lending to MSMEs/ emergency refinancing facility	Special credit guarantees	Regulatory forbearance
Lower-middle-income economies	BAN	√	(CGF planned)	(lending target)	√	√	(Collateral Registry Bureau planned)		√	√	√	√	√	√	√
	IND	√ (MUDRA)	√	(lending target)	√	√	√	√ (SIDBI)	√		√	√	√	√	√
	NEP	√	√	√	√	√	√		√	√ (agriculture, women)	√	√	√		√
	PAK	√	√		√	√	√	√ (SME Bank)	√	√ (women)	√	√	√	√	√
	SRI	√	(NCGI planned)		√	√	√	√	√	√ (youth, women, priority sectors)	√	√	√	√	√

BAN = Bangladesh; COVID-19 = coronavirus disease; CGF = Credit Guarantee Fund; IND = India; MSME = micro, small, and medium-sized enterprise; MUDRA = Micro Units Development and Refinance Agency (India); NCGI = National Credit Guarantee Institution; NEP = Nepal; PAK = Pakistan; SIDBI = Small Industries Development Bank of India; SME = small and medium-sized enterprise; SRI = Sri Lanka. Source: ADB Asia SME Monitor 2021 database.

The ADB-funded SME Line of Credit provides financial intermediation targeting MSMEs and women entrepreneurs. It included an SME Emergency Response Component in response to the pandemic.

Performance of ADB's SME Line of Credit Project (disbursement as of end June 2022)

Scheme	SME Credit Line							COVID-19 Emergency Response Working Capital Facility				
Key Objective	Promote capital investments by underserved SMEs including women and entrepreneurs							Support SME's recovery from the pandemic				
ADB Financial Modality (allocated amount)	1st loan (\$100 million), 2nd loan (\$75 million), and 3rd loan (\$31.5 million)						We-Fi grant (\$8.25 million)		3rd loan (\$100 million)			
Loans Disbursed and Grants	Amount of Loans		Number of Loans				Amount of Grants		Number of Loans		Number of Loans	
	Total		Total	Women-led	First Borrower		Total	Total	Total	Total	Non collateralized	
	SLR million	Number	Number	% to total	Number	% to total	SLR million	Number	SLR million	Number	Number	% to total
Bank of Ceylon	3,103.0	691	357	51.7%	304	44.0%	201.8	276	1,565.3	337	209	62.0%
People's Bank	2,293.9	318	103	32.4%	62	19.5%	53.0	41	1,086.3	250	110	44.0%
Regional Development Bank	3,122.8	1,305	544	41.7%	251	19.2%	151.1	220	1,074.4	724	604	83.4%
DFCC Bank	3,735.6	262	88	33.6%	52	19.8%	147.6	95	1,106.0	148	32	21.6%
Sampath Bank	2,954.4	174	74	42.5%	58	33.3%	156.7	40	1,176.2	154	32	20.8%
Hatton National Bank	3,897.8	292	103	35.3%	84	28.8%	99.0	46	1,651.6	246	52	21.1%
Commercial Bank	3,225.8	217	98	45.2%	50	23.0%	204.5	63	1,902.5	296	66	22.3%
NDB	4,912.8	424	155	36.6%	118	27.8%	195.6	76	1,081.5	151	44	29.1%
Seylan Bank	1,906.3	115	51	44.3%	27	23.5%	143.5	35	1,830.8	246	70	28.5%
Nations Trust Bank	2,417.7	135	33	24.4%	30	22.2%	34.7	11	1,929.7	232	56	24.1%
Sanasa Development Bank	...	...	...	...	...	0.0%	n/a.,					
Pan Asia Bank	30.0	1	...	...	...	0.0%						
Union Bank of Colombo	110.0	3	...	...	1	33.3%						
Total	31,710.1	3,937	1,606	40.8%	1,037	26.3%	1,387.6	903	14,404.3	2,784	1,275	45.8%

SME = small and medium-sized enterprise, We-Fi = Women Entrepreneur Finance Initiative.

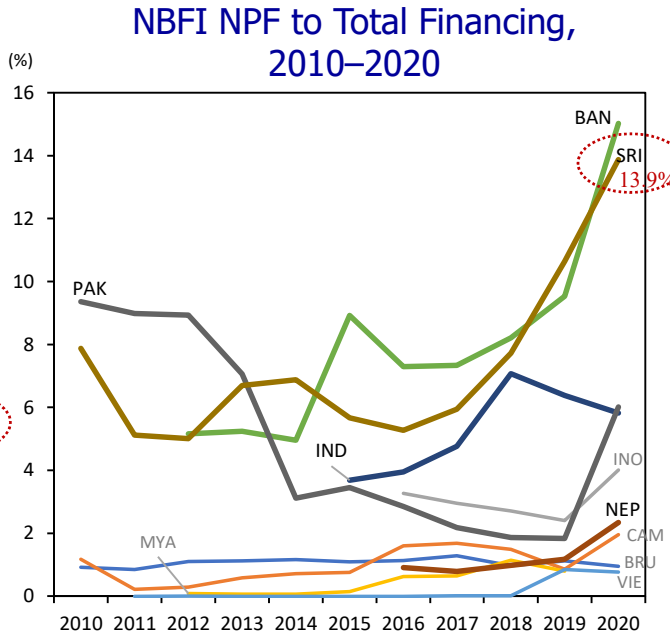
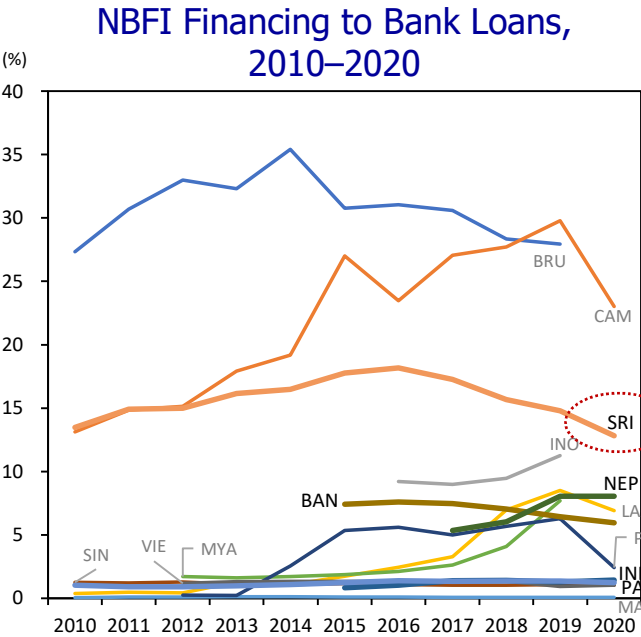
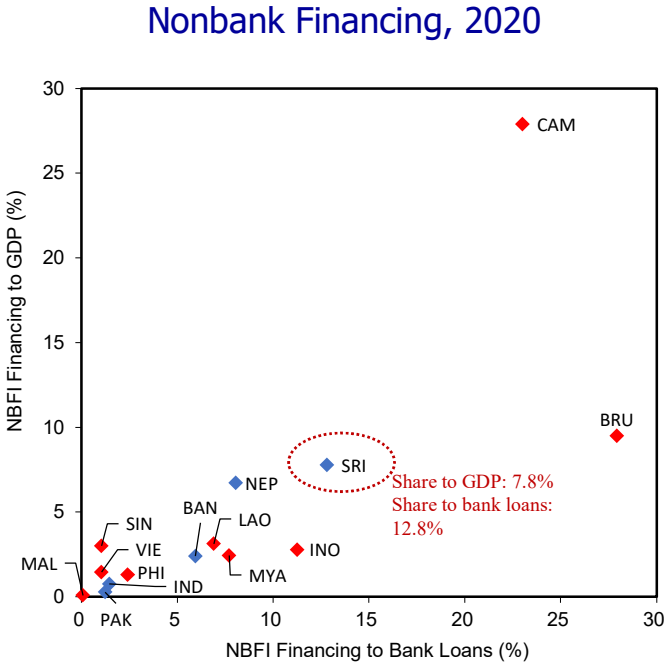
Source: Monthly Progress Reports of the Ministry of Finance.

Notes:

- In addition to the two schemes above, the ADB's SME Line of Credit Project has an affordable credit line for tea smallholders for capital investments, such as replanting.
- Sanasa Development Bank, Pan Asia Bank, and Union Bank of Colombo joined SME Credit Line in January 2022. All other banks have been operating since January 2016.



The nonbank finance industry is gradually developing. It supports MSME working capital needs, but it remains small in scale and has recently slowed.

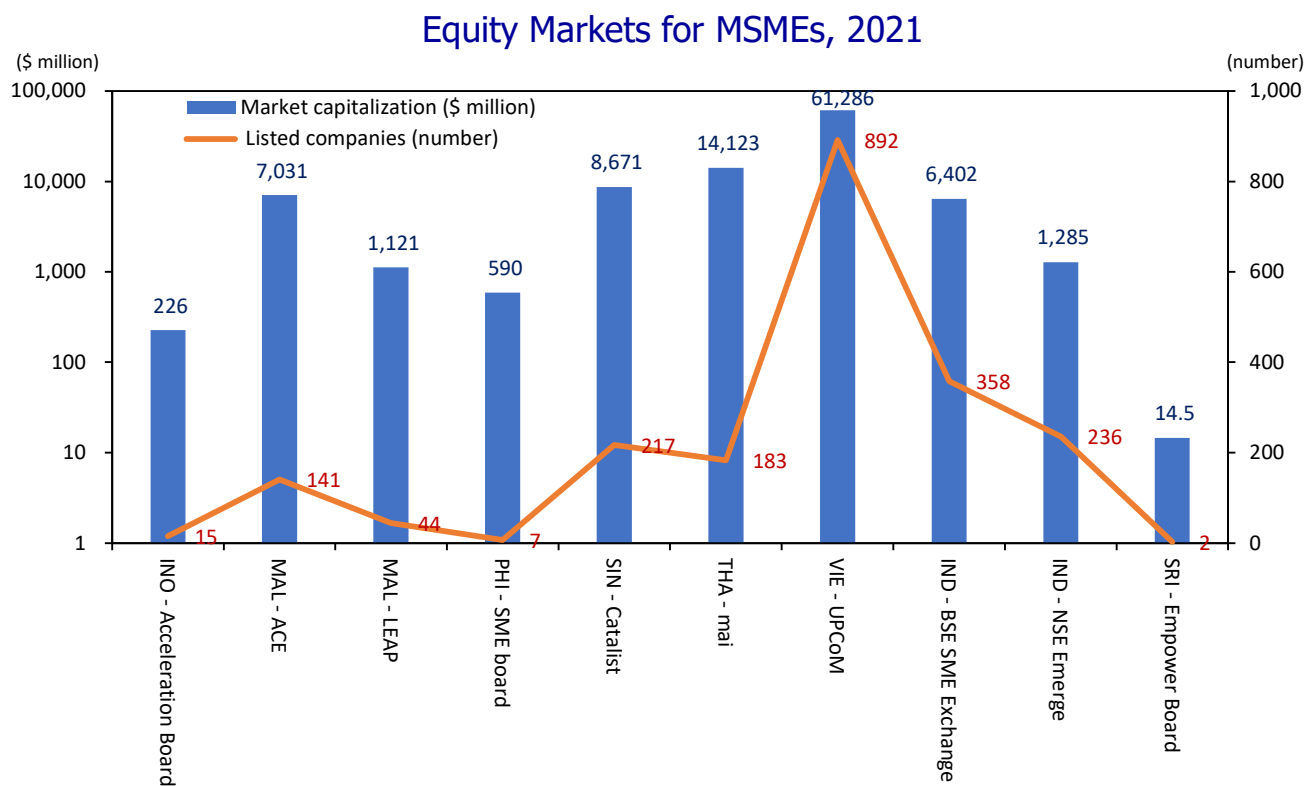


BAN = Bangladesh, BRU = Brunei Darussalam, CAM = Cambodia, IND = India, INO = Indonesia, LAO = Lao PDR, MAL = Malaysia, MYA = Myanmar, NBFI = nonbank finance institution, NEP = Nepal, NPF = nonperforming financing; PAK = Pakistan, PHI = Philippines, SIN = Singapore, SRI = Sri Lanka, VIE = Viet Nam.
 Note: NBFI data varies by country: Bangladesh (nonbank finance institutions regulated by Bangladesh Bank); Brunei Darussalam (finance companies and pawnbrokers); Cambodia (microfinance institutions and leasing companies); India (nonbank finance institutions regulated by Reserve Bank of India; MSME financing only); Indonesia (finance companies, microfinance institutions, and government pawnshops); Lao PDR (microfinance institutions, pawnshops, and leasing companies); Malaysia (private equity, venture capital, factoring, and leasing companies); Myanmar (microfinance institutions); Nepal (microfinance institutions); Pakistan (microfinance institutions and leasing companies); Philippines (credit unions and cooperatives [2015–2018], pawnshops [2009–2018], and nonstock savings and loans associations [NSSLAs; 2014–2020]); Singapore (finance companies); Sri Lanka: (nonbank finance institutions regulated by Central Bank of Sri Lanka: 4 microfinance institutions, 40 finance companies, and 3 leasing companies, as of end-2020); Viet Nam (People’s Credit Funds and microfinance institutions).
 Source: ADB Asia SME Monitor 2021 database.



Specialized SME equity markets have emerged as growth capital financing venues for eligible MSMEs in developing Asia; yet there are few issuers and investors.

- Market-based financing to businesses has grown gradually in Sri Lanka, with a new Empower Board open for viable SMEs to list for growth capital financing.



BSE = Bombay Stock Exchange, IND = India, INO = Indonesia, MAL = Malaysia, NSE = National Stock Exchange, PHI = Philippines, SIN = Singapore, SRI = Sri Lanka, THA = Thailand, VIE = Viet Nam. Source: ADB Asia SME Monitor 2021 database and updates.



What affected the MSME development in South Asia? SME Development Index (SME-DI) exercise

- Three principal components from the probabilistic PCA (P-PCA) estimated by expectation-maximization (EM) algorithm.

A. Time Series Plots of Estimated PCs (5 South Asian countries)



	PC1	PC2	PC3
Eigenvalue	4.58	3.10	1.59
Contribution ratio	0.62	0.18	0.08
Cumulative contribution rate	0.62	0.80	0.88

B. What variables drive these factors?

Country	Variables	PC1	Country	Variables	PC2	Country	Variables	PC3
Pakistan	Nonbank loans	0.87	India	Number of employees in SMEs	0.91	Pakistan	Bank loans for SMEs	0.73
India	Bank loans for SMEs	0.79	Pakistan	Market capitalization	0.82	Nepal	Market capitalization	0.61
Bangladesh	Bank loans for SMEs	0.75	Pakistan	GDP of SMEs	0.75	India	Market capitalization	0.56
Nepal	Number of SMEs	0.72	Sri Lanka	Nonbank loans	0.73	Pakistan	Market capitalization	0.52
Nepal	Market capitalization	0.63	Sri Lanka	Market capitalization	0.55	Pakistan	Nonbank loans	0.41
Sri Lanka	Nonbank loans	0.62	Bangladesh	Market capitalization	0.35	Bangladesh	Nonbank loans	0.17
Nepal	Number of employees in SMEs	0.61	Bangladesh	Bank loans for SMEs	0.21	Pakistan	GDP of SMEs	0.08
Pakistan	GDP of SMEs	0.58	India	Number of SMEs	0.18	Sri Lanka	Nonbank loans	0.05
India	Number of SMEs	0.55	Nepal	Number of employees in SMEs	0.13	India	Number of employees in SMEs	-0.01
Bangladesh	Nonbank loans	0.39	Pakistan	Nonperforming nonbank loans	0.10	Sri Lanka	Market capitalization	-0.02
India	Market capitalization	0.32	Nepal	Market capitalization	0.02	Pakistan	Nonperforming loans by SMEs	-0.02
Sri Lanka	Nonperforming nonbank loans	0.25	India	Bank loans for SMEs	0.01	India	GDP of SMEs	-0.04
India	Number of employees in SMEs	0.23	Pakistan	Nonbank loans	-0.04	Bangladesh	Market capitalization	-0.07
Bangladesh	Market capitalization	0.18	Pakistan	Nonperforming loans by SMEs	-0.05	Pakistan	Nonperforming nonbank loans	-0.09
Bangladesh	Nonperforming nonbank loans	0.01	Nepal	Number of SMEs	-0.06	India	Bank loans for SMEs	-0.13
Pakistan	Market capitalization	-0.06	Sri Lanka	Nonperforming nonbank loans	-0.13	Bangladesh	Bank loans for SMEs	-0.24
Pakistan	Bank loans for SMEs	-0.16	Pakistan	Bank loans for SMEs	-0.63	Bangladesh	Nonperforming nonbank loans	-0.40
India	GDP of SMEs	-0.23	Bangladesh	Nonperforming nonbank loans	-0.71	India	Number of SMEs	-0.55
India	Export from SMEs	-0.27	India	Market capitalization	-0.71	India	Export from SMEs	-0.56
Sri Lanka	Market capitalization	-0.75	India	Export from SMEs	-0.74	Nepal	Number of SMEs	-0.63
Pakistan	Nonperforming nonbank loans	-0.85	Bangladesh	Nonbank loans	-0.81	Nepal	Number of employees in SMEs	-0.67
Pakistan	Nonperforming loans by SMEs	-0.97	India	GDP of SMEs	-0.93	Sri Lanka	Nonperforming nonbank loans	-0.83

PC = principal component, PCA = principal component analysis.
 Notes: The model refers to Tipping and Bishop (1999). Probabilistic PCA (P-PCA) assumes all the data are generated by a linear system of latent variables. Given the data, it obtains the model parameters by maximizing the likelihood function. Aggregate MSME data obtained from the Asia SME Monitor 2021 database (Bangladesh, India, Nepal, Pakistan, and Sri Lanka) were used for analysis.
 Source: ADB Asia SME Monitor 2021 Vol.4. <https://www.adb.org/publications/asia-sme-monitor-2021-volume-4>.



SME-DI exercise (South Asia): summary of the estimates

- In South Asia, nonperforming MSME loans in Pakistan and stagnant MSME exports in India slowed the region's MSME development after the 2008–2009 global financial crisis (GFC) through 2014.
- A recovery in capital markets in Pakistan and Sri Lanka, improved MSME employment in India, and increased productivity of small manufacturers in Pakistan, all these factors contributed to a recovery among South Asia's MSMEs from 2012 to 2015.
- After 2016, increased MSME bank loans in India and Bangladesh, nonbank loans in Pakistan and Sri Lanka, and the rising number of MSMEs in Nepal all supported region's MSME development.
- The estimation results suggest the critical role of finance, especially channeling growth capital to viable MSMEs via diversified financing options, to promote their smooth recovery from the crisis.

Policies and Regulations

MSME Development Policies

- Governments have comprehensive long-term MSME policies in line with their national development strategies in South Asia.
- Support areas: a conducive business environment, access to markets and finance, skills development, business cluster development, use of technology, digitalization, and focused groups such as youth and women entrepreneurs, startups, agribusiness, and MSME exporters (participation in global value chains).
- MSMEs are defined by national policy frameworks or stipulated by law, generating a national single definition. But various MSME definitions are substantially used in several organizations.

MSME Policies and Act in South Asia

- SME Policy 2019, Bangladesh
- Micro, Small and Medium Enterprise Development Act of 2006, India
- Industrial Promotion Policy 2011, Nepal
- National SME Policy Action Plan 2020 (for SME Policy 2019), Pakistan
- **National Policy Framework for Small and Medium Enterprise Development 2015, Sri Lanka**

Source: ADB Asia SME Monitor 2021 database.

MSME Definitions in South Asia

Country	Category	Definition						Remarks
		Employee	Asset	Turnover	Capital	By Sector	Others	
Bangladesh	Cottage, micro, small, and medium-sized firm	✓	✓			✓		Defined by the National Industrial Policy 2016.
		✓	✓	✓		✓		Utilized by central bank.
India	Micro, small, and medium-sized firm			✓			✓	Micro, Small and Medium Enterprise Development Act, 2006 (amended June 2020).
Nepal	Cottage, micro, small, and medium-sized firm	✓	✓	✓			✓	Industrial Enterprises Act, 2020
Pakistan	Start-up, small, and medium-sized firm			✓			✓	Defined by the National SME Policy 2020.
	Micro, small, and medium-sized firm	✓		✓				Utilized by central bank.
	Small firm	✓		✓	✓		✓	Utilized by Federal Board of Revenue.
Sri Lanka	Micro, small, and medium-sized firm	✓		✓			✓	Defined by the National Policy Framework for SME Development (2015).
		✓				✓		Utilized by statistics office (Economic Census).



Policies and Regulations

Financial Inclusion Strategies

- Comprehensive national financial inclusion strategies were formulated during 2015–2021 in South Asia.
- Common strategic goals: (i) digital finance and payments, (ii) financial literacy and education, (iii) consumer protection, and (iv) financial assistance for traditionally unserved and underserved segments—including MSMEs, women entrepreneurs, and priority sectors such as agriculture.
- Bangladesh and Sri Lanka address creating robust financial inclusion data for effective monitoring and policy interventions.
- Financial inclusion strategies are holistic but remain somewhat bank centric.
- Intragovernmental coordination between central government and financial authorities is well-established to implement and fine-tune policies.

National Financial Inclusion Strategies in South Asia

- National Financial Inclusion Strategy of Bangladesh 2020–2024
- National Strategy for Financial Inclusion 2019–2024, India
- Financial Inclusion Roadmap 2017–2022, Nepal
- National Financial Inclusion Strategy 2015, Pakistan
- **National Financial Inclusion Strategy for Sri Lanka 2021–2024**

Source: ADB Asia SME Monitor 2021 database.



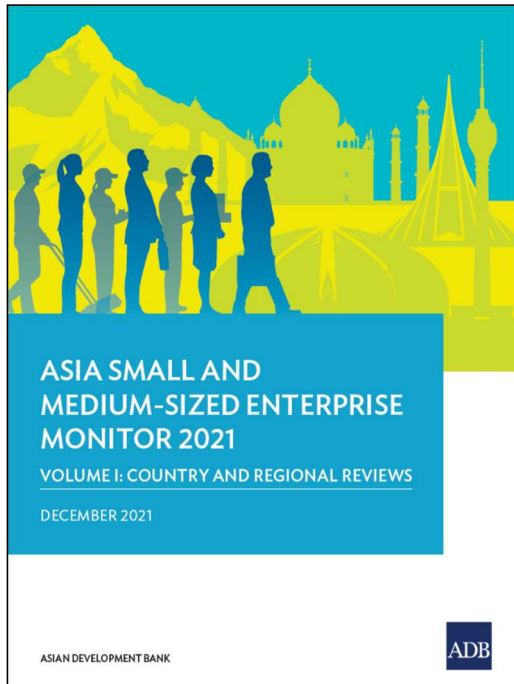
Awareness of Issues

1. MSMEs, mainly comprised by distributive trade, are exclusively focusing on domestic markets, and **the base of entrepreneurship**—an essential component for inclusive growth—has yet to be established in Sri Lanka.
2. The expansion of growth-oriented firm base, with **innovation** and **internationalization**, will contribute to unlock new productivity in the country; hence, it is critical to foster this group to bounce back the economy from the recent crisis.
3. Finance is a critical engine for businesses to survive and grow during and post economic crisis, yet MSME access to formal financial services remains limited.
4. Further enhancing access to bank credit and nonbank financing is needed for MSMEs to raise working capital, while the venue for **growth capital financing** to viable MSMEs should be promoted further.

The Way Forward

- Sri Lankan economy could recover and boost its resilience to shocks by strengthening MSME growth and dynamics.
- **Formalizing** and **internationalizing** MSMEs, with fostering innovative MSMEs and youth/women entrepreneurs, would accelerate economic recovery and ensure resilient, inclusive growth.
- Business development and advisory services (**one-stop service window**) should be strengthened further, especially for youth/women entrepreneurs.
- Assistance for **digital transformation** of MSME business is another policy priority, addressing informal sectors.
- Assistance to reduce utility costs and retain employees (subsidies) would be worth consideration for MSMEs.
- Further **diversified financing options** are needed for viable MSMEs. More attention should be paid to market-based financing (capital markets) and digital finance platforms.
- Developing **data infrastructure** is key to promoting evidence-based assistance for MSMEs.

For more details...



- Asia Small and Medium-Sized Enterprise Monitor 2021: Volume I–Country and Regional Reviews

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Thank you for your attention.

For further questions:

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