

**NATIONAL STRATEGY FOR
SMALL AND MEDIUM
ENTERPRISE SECTOR
DEVELOPMENT
IN SRI LANKA**

White Paper

Prepared by:

Task Force

for

**Small & Medium Enterprise Sector
Development Program**

December 2002

Contents

Submission to the Minister	iii
Acknowledgements	vi
Abbreviations	vii
Executive Summary	1
PART ONE	
The Process and Vision	5
1.1 The Establishment and Role of the Task Force	5
1.2 Structure of the document	6
1.3 A broader Vision	6
1.4 SME Vision for Sri Lanka	8
1.5 The way forward	12
PART TWO	
A Profile of the Small & Medium Enterprise Sector in Sri Lanka	14
2.1 Size and diversity of the sector	14
2.2 Defining what is an SME	21
2.3 Constraints facing SMEs	24
PART THREE	
Objectives and Principles for a National Strategy	29
3.1 Objectives of the national SME strategy	29
3.2 Making the national strategy operational	32
3.3 Fundamental principles	33
PART FOUR	
Enabling Business Environment	36
4.1 Access to Finance	36
4.2 Access to appropriate technology	41
4.3 Access to information and markets	45
4.4 Business development services	48
4.5 Linkage formation: clustering and subcontracting	50
4.6 Infrastructure	51
4.7 Enabling legal and regulatory framework	53

4.8	Industrial relations and the labour environment	56
4.9	Entrepreneurship skills, retraining and management	57
4.10	Cleaner Production and Environmental Issues	59
PART FIVE		
Institutional Support 62		
5.1	Government institutions pertaining to SME development	62
5.2	Private sector institutions supporting SMEs	67
5.3	Non-governmental and Multilateral-bilateral donor agencies supporting SMEs	68
5.4	An overall assessment	68
5.5	Recommended strategies	71
PART SIX		
Action Program 79		
6.1	An integrated view	79
6.2	Short term — end of 2003	81
6.3	Medium term — 2004 to 2005	87
6.4	Long term — 2006 to 2010	89
PART SEVEN		
Funding the Implementation of the Strategy 91		
APPENDICES		
1.	Public Hearings	94
2.	List of Task Force Members	95
3.	List of Support Staff to the Task Force	96

Hon. Prof. G. L. Pieris

Minister of Enterprise Development, Industrial Policy, and Investment Promotion

Ministry of Enterprise Development, Industrial Policy, and Investment Promotion

73/1, Galle Road

Colombo 3.

Dear Hon. Minister,

Final Report on the National Strategy for Small & Medium Enterprise Sector Development in Sri Lanka

Small and Medium Enterprises (SMEs) have been recognized as an important strategic sector for generating high economic growth and reducing unemployment, inequality and poverty. Since 1948, successive governments have introduced various support programmes to facilitate growth and expansion of SMEs in different sub-sectors of the national economy. However, there has been no deliberate policy effort to exploit the full development potential of SMEs. In fact, past policies and incentives for enterprise development have been highly biased towards large-scale enterprises and hence discriminatory against SMEs. It is a sector which needs to be carefully nurtured by providing institutional support, access to finance, business development services, and less regulatory oriented business environment.

Having recognized this major policy requirements, the then Minister in charge of Industrial Development appointed a Task Force (TF) in October, 2001 to inquire into the needs, problems, and future requirements of SMEs and develop a National Strategy for Sri Lanka.

After a long deliberation on the main tasks assigned, the TF decided to adopt the following methodology in order to ensure wider participation of stakeholders in formulation of policies and strategies for SME development.

- i) Develop the mission and key strategic elements for SMEs at a major workshop;
- ii) Formation of four working groups to prepare detailed reports on: a) overall policy, b) enabling business environment, c) institutional support, and d) action plan;
- iii) Conduct public hearing workshops in Colombo, Kandy, Matara and Trincomalee; and
- iv) Consultations with representatives from government, non-government and private sector organizations.

Peter Van Diermen, ADB/Consultant, provided useful methodological guidance during the initial discussions. Through its discussions and deliberations, the TF identified several constraints, affecting SMEs including limited access to and cost of capital, low level of technology, limited access to markets and market information, absence of business development services, regulatory and administrative constraints, and inadequate institutional support. The severity of these issues on SME development was addressed in the context of on going policy reforms at the domestic front and increasingly competitive market conditions at global level.

The strategic elements identified by the TF were: public policy, institutional reform, inter-institutional co-ordination, developing staff and institutional capacity, financing, technology, information and market access, business development services, entrepreneurial skills, regulatory framework, infrastructure, industrial relations and labour, linkage formation, and environmental issues. The Action Plan prepared by the TF spells out specific activities under each strategic element in terms of time targets and institutions responsible for implementation.

It is the view of the TF that much remains to be done to strengthen the relative position of the SMEs in the national economy. The recommendations given in the White Paper are based on the policy formula of “maximum support but minimum intervention.” Under this policy, the government does not interfere directly in the market, but it provides a favourable macroeconomic environment, institutional support and infrastructural facilities. The government plays largely a coordinating and

National Strategy for the SME Sector in Sri Lanka

facilitating role. It is hoped that the incumbent government and future governments would take into account the overall strategy and implement action programmes recommended in this White Paper to uplift the SME sector in Sri Lanka.

.....
(Sgd.) Saman Kelegama
(Chairman)

.....
Ranjith Fernando
(Member)

.....
(Sgd.) Roy Jayasinghe
(Member)

.....
(sgd.) Nihal Abeysekera
(Member)

.....
(Sgd.) S.J. Silva
(Member)

.....
(Sgd.) Chandra Embuldeniya
(Member)

.....
(Sgd.) K.P.N.S. Karunagoda
(Member)

.....
(Sgd.) A.K. Ratnanarajah
(Member)

.....
(Sgd.) Walter Gunawardena
(Member)

.....
(Sgd.) Aloy Jayawardena
(Member)

.....
(Sgd.) Bandula Perera
(Member)

.....
(Sgd.) Kosala Wickreamanayake
(Member)

.....
(Sgd.) G. Gunawickrema
(Member)

.....
(Sgd.) Nihal Fonseka
(Member)

.....
(Sgd.) Edgar Gunatunga
(Member)

Acknowledgements

The Task Force for Small & Medium Enterprise Sector Development Programme wishes to acknowledge and thank the Task Force's Secretariat for its untiring work in coordinating the meetings and preparing the minutes. We would like to record our particular thanks to Menike Chandrasiri and S. Hettiarachchi of the Secretariat.

Thanks are due to Shihana Samad, Thushari De Zoysa, Malathy Knight-John, Aravinda Perera and E.M. Wijethilake who were co-opted into the Task Force from time to time and made valuable contributions. Our thanks also go to all participants and contributors of the Public Hearings in Matara, Kandy, Colombo and Trincomalee. Shenuka Chanmugam deserves special thanks for coordinating the work of the Task Force with the Asian Development Bank.

This report could not have been completed without the dedication and commitment of the key consultant, Sunil Chandrasiri. We are extremely grateful for his input. The inputs of other consultants, *viz*: Athula Ransinghe, Mahinda Gunasekera, and Peter Van Diermen are also appreciated.

Finally, we would like to record our thanks to Harry Waidyasekera for editing the manuscript and Malini Fernando for formatting the text.

Task Force Members

December 2002

Abbreviations

ADB	Asian Development Bank
BDS	Business Development Services
BDSP	Business Development Service Providers
BISL	Bankers' Institute of Sri Lanka (Institute of Bankers of Sri Lanka)
BOI	Board of Investment
CB	Central Bank of Sri Lanka
CEA	Central Environment Authority
CSE	Colombo Stock Exchange
CPU	Cleaner Production Unit
DCS	Department of Census and Statistics
DCOM	Department of Commerce
DoC	Department of Customs
DIR	Dept. of Inland Revenue
EDB	Export Development Board
EPZ	Export Processing Zone
FIs	Financial Intermediaries
GSMB	Geological Survey and Mines Bureau
GST	Goods and Services Tax
IDB	Investment Development Board
ILO	International Labour Organisation
IMF	International Monetary Fund
ITA	Investment Tax Allowance
ITI	Industrial Technology Institute
JICA	Japan International Cooperation Agency
MAL	Ministry of Agriculture and Livestock
MCOM	Ministry of Commerce and Consumer Affairs
MENR	Ministry of Environment and Natural Resources
MERST	Ministry of Economic Reform, Science and Technology
MF	Ministry of Finance
MFA	Multi-Fibre Agreement
MEDIPIP	Ministry of Enterprise Development, Industrial Policy and Investment Promotion
MEL	Ministry of Employment and Labour
MHPI	Ministry of Housing and Plantation Industries
MHRDECA	Ministry of Human Resource Development, Education and Cultural Affairs
MI	Ministry of Industries
MLD	Ministry of Lands and Development
MMC	Ministry of Mass Communication
MPDI	Ministry of Policy Development and Implementation
MRD	Ministries responsible for Regional Development e.g. Ministry of Southern Region Development, Ministry of Central Region

	Development etc.
MSE	Ministry of School Education
MTET	Ministry of Tertiary Education and Training
MT	Ministry of Tourism
NCPC	National Cleaner Production Centre
NGO	Non-Government Organisation
NOR	National Operations Room
NPS	National Productivity Secretariat
NSL	National Security Levy
PCM	Provincial Council Ministries
RC	Regional Chambers
RDB	Regional Development Banks
RISC	Regional Industries Service Committee
SMEs	Small and Medium Enterprises
SMED	Small and Medium Enterprise Developers Project
SMEA	Small and Medium Enterprise Development Authority
SMIDEC	Small and Medium Industry Development Corporation
SMEPU	Small and Medium Enterprise Policy Unit
SMIs	Small and Medium Industries
SPX	Subcontracting and Partnership Exchange
TAC	Tariff Advisory Committee
TEVT	Technical Education and Vocational Training
UNIDO	United Nations Industrial Development Organisation
UNDP	United Nations Development Programme
USAID	United States Agency for International Development

Executive Summary

1. Small and medium enterprises (SMEs) have been identified as an important strategic sector for promoting growth and social development of Sri Lanka. Over the years, SMEs have gained wide recognition as a major source of employment, income generation, poverty alleviation and regional development. The SMEs cover broad areas of economic activity such as agriculture, mining, manufacturing, construction and service sector industries. Although SMEs encompass agriculture, manufacturing and service sector establishments, reliable data are available only for the manufacturing sector. Within the manufacturing sector, small and medium scale industries (SMI) account for about 96 per cent of industrial units, 36 per cent of industrial employment and 20 per cent of value added. However, the total contribution of SMEs to the national economy cannot be estimated due to paucity of information.
2. In spite of various policy reforms and incentives offered by successive governments with the assistance of various donor agencies during the post liberalization period, the SME sector enterprises are less dynamic and underdeveloped as against large-scale enterprises in the national economy. The growth and expansion of SMEs are constrained by problems relating to both product and factor markets. Lack of institutional support and policy inertia have further reduced the potential contribution of SMEs to the national economy. This White Paper attempts to address these issues within the current context of policy framework in Sri Lanka.
3. As a response to the above, a Task Force comprising of business people, members of Chambers and Industry, members of the academia, bankers and government officials was set up by the Ministry of Industry and Trade in order to develop a policy framework for SME development in Sri Lanka. The Task Force consulted widely with SME entrepreneurs, Chambers of Commerce and Industry, academia, policy makers, administrators and other stakeholders to ensure that the White Paper meets the current requirements of the SME sector and development challenges of the national economy. As a part of this process, the Task Force also conducted a series of public hearings in Colombo, Kandy, Matara, and Trincomalee with a view to incorporate the suggestions of entrepreneurs, NGOs, Chambers and public sector institutions engaged in SME development, especially at the district level. In addition, the evidence from both published and unpublished work on SME development was examined as a major part of the exercise. The Task Force has also taken maximum efforts to take into account the recommendations given in recent policy documents such as the Draft

National Employment Policy for Sri Lanka (2002), Business Incubators Programme (2002), Poverty Reduction Strategy Paper (2002), The Future – Regaining Sri Lanka (2002) and Budget Proposals (2002 and 2003).

4. The White Paper's vision and strategies explicitly address the concerns of entrepreneurs representing the small and medium enterprise sector within a national economy framework. That is, all initiatives for the SME sector set out in this White Paper are consistent with policy initiatives by other key Ministries such as Finance, Employment and Labour, Trade and Commerce, Lands, Education and Tertiary Education.
5. The economy-wide policy reforms initiated by the government clearly indicate its commitment towards an internationally competitive economy, combining growth and equity. Its long-term development objective is to achieve high level of economic growth implemented through an open economic system. Within this broad policy framework, the Task Force vision for **SMEs is to be globally competitive through an entrepreneurial culture committed to sustainable growth**. This requires the SME sector to be dynamic, robust, innovative and technologically-driven. The vision, strategies and objectives of the White Paper are aimed at overall socio-economic development and reduction of poverty.
6. The term 'enterprise' is defined to include any business activity or enterprise engaged in industry, agri-business and/ or services whether single proprietorship, partnership, or corporate venture. Having considered various definitional options, the Task Force agreed to define SME sector enterprises with **assets values not exceeding Rs. 50 Million per enterprise excluding land and buildings**. This value is to be adjusted for inflation once in five years based on the implicit GDP deflator. Using the same criteria, the Task Force also agreed to give a demarcation between Small and Medium Scale enterprises; a) **small scale enterprises** - asset values not exceeding **Rs. 20 Million** excluding land and buildings and, b) **medium scale enterprises** – asset values not exceeding **Rs. 50 Million** excluding land and buildings.
7. The most important objective of the national strategy is to create an enabling business environment for SMEs in Sri Lanka. The White Paper provides the requirements for this enabling environment for the achievement of a broad based, resilient and internationally competitive SME sector. It has also set in place policies and programmes to further develop and integrate SMEs with various sub-sectors of the national economy and global markets.
8. The objective of creating an enabling business environment is achieved by focussing on key strategic elements considered necessary for a

balanced and integrated national strategy. This broadly covers access to finance, physical infrastructure, technology, regulatory framework, access to information and advice, access to markets, business development services, industrial relations and labour, linkage formation and environmental issues.

9. The institutional support required for creating an enabling environment covers four strategic elements; a) establishing an **SME Authority** (SMEA), b) reform of existing institutions, c) inter-institutional co-ordination and, d) developing staff and institutional capacity. The SMEA is a supreme body recommended by the Task Force to cut across administrative and financial barriers and deliver national strategies for SME development. As spelt out in the White Paper, the SMEA is the focal point for institutional support and mainly responsible for the implementation of short-term, medium-term and long-term strategies for SME development.
10. The key recommendations of the White Paper developed along these lines are summarized below:
 - The government adopts the vision for the SME sector as set out in the White Paper in order to provide policy direction for future overall strategy and plans for implementation
 - The definition recommended by the Task Force is to be used as a standard for data collection, policy analysis and implementation of SME sector development programmes
 - Establish a high powered SME Policy Unit (SMEPU) at the Ministry of Enterprise Development, Industrial Policy & Investment Promotion
 - Establish an SME Authority (SMEA) – A full-fledged autonomous institution for SME development
 - Facilitate on going restructuring activities of the IDB with necessary funding and administrative support
 - Improve and consolidate financial assistance available for SMEs
 - Implement low cost credit negotiation and project monitoring activities initiated by the IDB
 - Encourage active participation of Venture Capital Companies and Leasing Companies to provide credit support for SMEs
 - Disburse loan and allied facilities with the assistance of BDS providers
 - Amend the Loan Recoveries Act and Provide opportunities for sick industries to reconstruct
 - Install financial discipline in SMEs
 - Establish ‘Technical Service Centres’ at District level
 - Establish a ‘Technology Development Fund’
 - Introduce a voucher scheme for SMEs to engage in R&D work

- Create an SME Web Site
- Initiate low cost advertising and sales promotion programmes for SMEs
- Commission an annual survey and a Magazine on SMEs
- Maintain a comprehensive and up-to-date business development services (BDS) data base
- Introduce a voucher scheme for SMEs to use BDSs
- Introduce a simplified tax system for the SMEs
- Obtain WTO concessions for SME development
- Organize productivity enhancement programmes for SMEs
- Creation of industrial parks for SMEs in rural areas
- Form industry clusters on sub-sector basis
- Promote sub-contracting with proper targeting for improving the technological capabilities of SMEs
- Launch an awareness programmes on cleaner production (CP) targeted at SMEs focusing on cost savings and efficiency benefits of CP
- Enhance the capability of government and private BDSs to assist SMEs in CP and environmental management.

11. The **Ministry of Enterprise Development, Industrial Policy & Investment Promotion (MEDIPIP)** is recommended as the implementing agent for the National SME vision and strategy. It is also recommended that the Ministry create and fund a specialised **SME Policy Unit (SMEPU)** as an interim administrative measure for effective co-ordination and implementation of **Action Programmes** recommended by the Task Force. The SMEPU is expected to carry out these activities until the proposed SMEA is established under a separate Act of Parliament. During this interim period, the SMEPU should function under the direction of a Governing Council which should consist of SME Task Force members. The Secretary to the MEDIPIP should be the Chairman of the Governing Council.

12. The proposals made with respect to each of the strategic elements are summarized in the Action Plan. These proposals need to be implemented with immediate effect to achieve the vision and objectives set out by the Task Force for SME development in Sri Lanka. This is an aspect which deserves special emphasis in view of wide diversity of institutions involved in SME development. It also requires overall political direction for the proposed strategies to achieve national goals. Hence, strong commitment and support from all stakeholders led by the Ministry of Enterprise Development, Industrial Policy & Investment Promotion is a precondition for realizing the vision and objectives.

PART ONE

The Process and Vision

13. This section of the White Paper deals with the establishment of the Task Force and its terms of reference. This is followed by a vision statement and explanation of its components. Together, these items provide the background and context for the rest of the White Paper.

1.1 The Establishment and Role of the Task Force

14. The government appointed a Task Force comprising of business people, members of Chambers of Commerce and Industry, members of the academia, bankers and government officials in order to develop a vision and strategy for the SME sector. The Task Force was given the responsibility to inquire into the needs, problems and future of SMEs in Sri Lanka. The specific terms of reference for the Task Force were as follows:
 - a) Analyse the contribution of SMEs to the Sri Lanka economy.
 - b) List the objectives and fundamental principles that underpin the national strategy.
 - c) Articulate the elements necessary for achieving a national vision/strategy.
 - d) Outline the institutional reforms necessary to achieve a national strategy for SME development.
 - e) Publicise an action plan that identifies short, medium and long term goals.
 - f) Identify a coordinating and implementing agency and sources of funding.
15. The Task Force consulted widely with SME entrepreneurs in industry and the service sector, Chambers of Commerce, academia, government officials and other stakeholders to arrive at a vision and strategy that has wide scale acceptance and support. As part of the government's inquiry into the SME sector, the Task Force set-up a series of public hearings at which entrepreneurs and other interested parties could express their concerns and view points. In addition to the public hearings, written submissions have also been sought.

16. The Task Force received assistance in its deliberations from a technical secretariat comprising national and international consultants, members from the Ministry of Enterprise Development, Industrial Policy & Investment Promotion and from the Institute of Policy Studies. The Asian Development Bank funded the work of the Task Force.

1.2 Structure of the document

17. In the rest of Part One the vision for the SME sector is laid out within a broader vision for the national economy. Part Two of the White Paper provides a profile of the SME sector in Sri Lanka. It describes the relative significance of the sector within the national economy. In doing so, it highlights the lack of a clear SME definition and the constraints facing the sector.
18. Part Three sets out the objectives and principles for a national strategy. It lists and elaborates the six key objectives of the national strategy. It also sets out the process for strategy formulation and implementation. The process is based on a number of fundamental principles that underpin the government's approach to small businesses and are set out in this part of the White Paper. Part Four identifies the crucial elements required for an enabling environment. These elements range from an efficient legal framework to environmental issues. Part Five complements the previous part in that it examines the institutional support necessary for the implementation of the national SME strategy. It identifies the Ministry of Enterprise Development, Industrial Policy & Investment Promotion, the Industrial Development Board and several other institutions directly linked with SME development. In doing so, it identifies the necessary reforms needed for these institutions to play the role they were intended to.
19. Part Six sets out an action program while Part Seven addresses the issue of funding. In combination these two parts complete the report and provide a detailed national SME strategy for the government to consider and adopt as policy.

1.3 A broader Vision

20. Sri Lanka is a developing economy with a per capita income of U.S. \$837 (2001). Since the introduction of a market-oriented policy framework in 1977, the economy has transformed from a traditional export-import type economy to a more outward looking export-oriented economy and

achieved average real GDP growth rate of 5 per cent per annum during the 1990s despite the civil war and turbulent economic environment at global level. The structural changes of the Sri Lankan economy during the post liberalization period is analyzed in Table 1.1 and 1.2. It reveals an increasing trend of service sector activities in the national economy as against the declining trend of the agricultural sector activities. During the same period, the relative share of the manufacturing sector has reduced marginally.

Table 1.1
Share of Gross Domestic Product (as per cent)

Sector	1978	1998	2001
Agriculture	30.3	21.1	20.1
Mining	2.2	1.9	1.8
Manufacturing	18.4	16.5	16.9
Construction	4.7	7.6	7.3
Services	44.4	52.9	53.9
GDP	100.0	100.0	100.0

Source: Central Bank of Sri Lanka Annual Reports

Table 1.2
Real Output (percentage change)

Sector	1997/98	1999	2000	2001
Agriculture	2.6	4.5	1.8	-3.0
Mining	-4.9	3.6	4.9	0.7
Manufacturing	6.3	4.4	9.2	-4.0
Construction	7.2	4.8	4.9	2.5
Services	5.2	4.2	6.9	-0.3
GDP	4.7	4.3	6.0	-1.4

Source: Central Bank of Sri Lanka Annual Reports

21. Despite the achievements during the post-liberalization period however, Sri Lanka's economic development has been far behind its counterparts in East Asia. In 2001, Sri Lanka recorded a negative real GDP growth of 1.4 per cent for the first time since Independence in 1948. However, in the first quarter of 2002, GDP recorded a marginal growth of 0.1 per cent over the corresponding quarter of the previous year. Currently, the Sri Lanka economy is confronted with major economic problems such as slow growth, low productivity, unemployment and underemployment, poverty, inadequate savings and investments, high rate of inflation, over borrowing, high interest costs and fiscal and external deficits. Solutions to these issues need to be worked out by taking into account ever increasing global competition on one hand and least cost to the economy

and social life on the other. Undoubtedly, SMEs could play an important role in meeting these challenges particularly in the areas of employment creation, income generation, poverty alleviation and regional development.

22. Most recent policy documents issued by the government clearly indicate its commitment towards a stable and internationally competitive economy, combining with growth and equity. This long-term development objective is to be achieved through a market oriented policy framework with projected growth targets of 5.5, 6.0 and 6.5 per cent for 2003, 2004 and 2005 onwards respectively¹. Some of the most recent policy documents discuss feasibility and implications of achieving 10 per cent annual growth targets². In line with the above challenges and projected growth targets the vision for SMEs has been defined.

1.4 SME Vision for Sri Lanka

23. In the process of defining the vision statement for SMEs the Task Force paid particular attention to the following considerations:

- a) Current socio-political-economic conditions and future challenges of the national economy,
- b) Current status of SMEs in the national economy,
- c) International best practice experience particularly the experience of Asian countries,
- d) The Task Force values and beliefs as they related to the SME sector and more broadly to the Sri Lankan economy, and
- e) The Task Force's future aspirations for the SME sector.

24. Moreover, in developing the vision the Task Force considered the broader economic setting of the national economy and likely changes at global level. Thus, the vision is consistent with the broader economic policy reforms during the post-liberalization period. This refers to liberalization of trade and industry and more recently the deregulation of key economic sectors. The Task Force's vision also recognises the reality of a globalising world in which Sri Lanka must operate. Sri Lanka's firms are responding to market signals from an increasingly integrated/borderless world. For example, the Indo-Lanka Free Trade Agreement, operationalised in March 2000 and the proposed Sri Lanka- Pakistan Trade Agreement, will have a significant impact over the next few years. Moreover, WTO rules, SAPTA and other bilateral trade agreements would also encourage competition from foreign sources. This evidence

¹ Central Bank of Sri Lanka, Annual Report, 2001.

² The Future – Regaining Sri Lanka.

demonstrates the increasingly competitive nature of domestic economic activity and the context in which a vision for SMEs must fit.

25. The Task Force recognises that the current situation in the SME sector is a long way from the vision that it has set out below. However, the vision provides an ideal position that can be embraced by all stakeholders. It provides a long-term goal for the government, policy makers, Chambers of Commerce and Industry and SMEs themselves to target. These strategies are more fully discussed in the later parts of the White Paper.

SMEs to be globally competitive through an entrepreneurial culture committed to sustainable growth.

26. The vision of Sri Lanka's SME sector can be disaggregated into several important elements. We assume that 'globally competitive' requires the sector to be dynamic, robust, innovative and technologically driven. The vision also assumes the existence of an entrepreneurial culture in which the role of SME entrepreneurs are recognized and respected by policy makers, administrators and others involved in SME development.
27. **Global competitiveness** assumes that SMEs are able to compete domestically against imports and access international markets for their products and services. The ability to compete may occur in a variety of ways including being competitive in price or quality. Competitiveness may also come from being able to network with other SMEs or through linking with larger enterprises.
28. **A competitive domestic market** is an essential prerequisite for SMEs to be internationally competitive. Domestic industry segments that receive assistance are sometimes unable to compete in the international market place. Furthermore, protection, by tariffs or other means while beneficial for infant industry promotion may create high cost domestic industries that are paid for by domestic consumers and taxpayers through higher prices and taxes.
29. The vision of an internationally competitive SME sector also assumes the existence of an **entrepreneurial culture**. This implies a culture in which small businesses people are respected and entrepreneurship is a highly prized characteristic. Education plays a vital role in developing and instilling entrepreneurial skills and values. In addition to specialist business courses, entrepreneurial skills and values need to be woven throughout the education system from the early years of education

through to university and vocational training. Leadership also plays an important role in increasing awareness and respect for the importance of entrepreneurship. Recognition and promotion of the critical significance of entrepreneurship should come from all quarters of society, particularly politics, business and academia. Moreover, support needs to come from the highest levels of civil society, so as to set an example and lead to the development of new social norms.

30. The concept of **Sustainable growth** encompass three major points of view: economic, social and environmental concerns. On practical terms this implies maximization of the net benefits of economic and social development subject to maintaining the services from, and stock of natural resources over time. The implementation of sustainable growth will require a pluralistic and consultative social framework that, among other things, facilitates the exchange of information between different social groups in order to identify cleaner production systems for overall socio-economic development
31. **The government** must take a lead role in facilitating the development of an internationally competitive economy – including the SME sector. An international competitive SME sector assumes a significant role for government. Because of their size and in comparison to large corporations, SMEs have less bargaining power when it comes to negotiating their regulatory environment. Moreover, the regulatory burden often impact more heavily on SMEs because of the indivisibility of government fees, levies and time taken to comply. Unnecessary regulations can significantly raise the transaction cost of doing business. Therefore, for a competitive sector there is a need for an economic environment that is conducive to business. Some of the immediate requirements for such an environment require user friendly legislation and regulations. In general, the regulatory environment needs to be transparent, predictable, stable, consistent and timely in implementation. Overall, the economic environment, comprising policies, regulations and institutions needs to engender a climate of trust in which businesses can compete and cooperate.
32. In terms of broad policy framework, it is accepted that policy adjustments and economic reforms are needed to strengthen the economy and improve growth prospects. A fundamental prerequisite for this is to establish macroeconomic stability and for the private sector to perform within a framework of stable and transparent policies. This implies a policy regime based on “maximum support and minimum intervention.” Under this policy, the government’s role should be to encourage and facilitate the development of efficient markets and to provide satisfactory infrastructure facilities where the private sector alone cannot provide them.

33. The vision also assumes a **dynamic, robust and innovative SME sector**. Businesses have to be able to respond **dynamically** to domestic and international market signals. They need the ability to withstand sudden adverse shocks in a **robust** manner. In a rapidly changing global political economy it is essential for businesses to be able to adapt quickly to changes through **innovation**. Dynamism implies not only the ability to respond to change but also to anticipate and take advantage of opportunities that occur during times of change.
34. A **dynamic SME sector** also allows for easy entry and exit and more importantly permits an easy scaling up and down of economic activity. This requires less distortions in markets of one sort or another. Furthermore, a dynamic and competitive SME sector requires timely access to information. Access to appropriate information allows entrepreneurs to make informed decisions — an essential requirement for a competitive sector and cooperative action. Information may mean many things, including the need for an affordable telecommunications, easy-to-understand regulations and ready access to listings of government rules.
35. An **innovative SME sector** implies the rapid absorption of new ideas and technologies that provide the sector with a competitive advantage. Furthermore, it suggests entrepreneurs are able to aggressively adapt and adjust ideas and technology of all kinds, to suit their unique market situation. It implies, entrepreneurs are not only recipients of technology but are able to apply and adapt them to suit their own needs — that is they are innovative.
36. Implicit in the vision, is the belief that the SME sector will continue to play an **important role in social development**. This belief is based on the sector's potential contribution towards employment creation, income generation, poverty reduction, gender, equity, and role in the production of goods and services consumed by low income earners of the population. The criteria for social policies, however, are very different from those designed and implemented to achieve a globally competitive SME sector.

Recommendation 1

The government adopts the vision for the SME sector as set out in the White Paper in order to provide policy direction for a future overall strategy and plans for implementation.

Recommendation 2

The government identifies the Ministry of Enterprise Development, Investment Policy and Investment Promotion as the key implementing agency for the White Paper's strategy.

1.5 The way forward

37. For the vision to be achieved over the next decade or less will require a coordinated effort by government and other stakeholders. The current position of the government vis-a-vis the SME sector falls well short of where we envisage it should be in the future.
38. While it is recognised that the government has a significant role to play, it is important to appreciate that this part is primarily as a facilitator rather than in direct intervention. Principally, the government should focus on enabling procedures rather than interventionist strategies. SME support programs are best conceptualized by institutions that most closely reflect the entrepreneurship and risk characteristics of small businesses themselves. Such institutions are often the Chambers, trade and industry promotion organizations, non-government organizations (NGOs), and private sector institutions.
39. For the vision and strategy to be meaningful and effective, the government must pay due attention to the implementation of recommended action programmes by such institutions. By and large, the **implementation of policy recommendations** in Sri Lanka is weak, due to various factors such as conflicting interests of different ministries, overlapping responsibilities of different ministries, conflicts between institutions at central and provincial level, lack of counterpart funds, cumbersome administrative procedures and political interference. In order to overcome these problems, it is extremely important that once the White Paper is endorsed by the Cabinet, immediate action has to be taken to implement the recommendations and action programmes of the White Paper.
40. The White Paper's vision and strategies address explicitly the concerns of entrepreneurs from the small and medium enterprise sector within a national economy wide framework. That is, all initiatives for the SME sector set out in this White Paper are consistent with an economy wide approach – incorporating all sectors. All specific SME sector policies must enhance economy wide efficiencies and thereby contribute towards long-term growth targets of the economy.

41. Some of the processes fall outside of the Task Force's remit and are functions for the government to consider in the process of implementing the White Paper's recommendations. However, the Task Force, in this White Paper, has set the tone and direction for government. It has done so by defining a vision that recognises the SME sector's past performance and the current direction of government policy. This vision, however, is not limited by the SME sector's past and sets a future agenda, which all stakeholders in the SME sector can aspire to and be an integral part.

PART TWO

A Profile of the Small and Medium Enterprise Sector in Sri Lanka

42. Before detailing the strategy for the small business sector it is important to identify the sector's contribution and the policy environment in which SMEs are operating. This Part also deals with the issue of defining SMEs and identifying the constraints most small businesses face. In its entirety, this Part of the White Paper sets the scene for the development of the national SME strategy.

2.1 Size and diversity of the sector

SME Sector

43. As stated earlier SMEs encompass establishments operating in agriculture, mining, manufacturing, construction and service sectors. However, its relative significance in the national economy cannot be estimated due to paucity of information. All the existing data sources lack accuracy and complete coverage of the 'enterprise sector' in spite of various government and semi-government institutions engaged in compiling SME related databases. With respect to small and medium scale industries (SMIs) however, the existing data base is more reliable and hence, it is possible to give some indication of the size of the sector on comparative basis. The time coverage selected for this purpose is 1983 and 1996. The former refers to 1983 Census of Industries and the latter as the latest year for which the Department of Census and Statistics could provide data on industry using a common format³. For the purpose of present analysis small size establishments were those enterprises employing between 5-29 people, medium 30-149 people and large 150 or more⁴.

³ In statistical terms however, there is some problem of comparability between the two years. The 1983 Census of Industries was a complete coverage of all industrial units including micro enterprises, whereas in 1996 complete count was applied only to establishments with 25 employees or more with a sample being used for industry segments with 5 to 25 employees.

⁴ This definition is essentially based on the common practice adopted by the Department of Census and Statistics in compiling data relating to industrial sector National Strategy for the SME Sector in Sri Lanka

44. The SMIs account for an overwhelming proportion of industrial establishments in Sri Lanka, but their share of employment and value-added is much smaller (Table 2.1). In 1996, as many as 96 per cent of all industrial enterprise units could be categorised as SMI according to the definitions given in para 41 above. They accounted for 36 per cent of all industrial employment and 20 per cent of all value-added. Within the SMI sector, it is the small industries, employing between 5 and 29 people that are predominant in terms of numbers, as 85 per cent of all industries happen to be small. In terms of employment, however, the small and medium subsectors contribute almost equally (about 18 per cent each), and in terms of value-added, the medium-scale subsector contributes three times as much as the small-scale subsector (15 per cent as against 5 per cent).
45. A comparison of the 1996 figures with those of 1983 shows that the importance of SMIs has remained virtually unchanged in terms of numbers but their contribution to employment and value-added has clearly declined (Table 2.1). The combined share of the SMI sector in industrial employment has declined from about a half to about one-third, and their share in value-added has declined from just under a third to about one-fifth. The decline has been particularly sharp for the smaller segment of the SMI sector, whose contribution to employment has declined from 29 per cent to 19 per cent and the contribution to value-added has fallen from 11 per cent to just 5 per cent

Table 2.1
Relative Size of SMIs: 1983 and 1996 (%)

Size group	1983			1996		
	Establishments	Employment	Value added	Establishments	Employment	Value added
Small	86.6	29.2	11.3	85.4	18.7	4.9
Medium	11.4	19.4	19.8	10.7	17.6	14.7
Large	2.0	51.4	68.9	3.9	63.7	80.4
All	100	100	100	100	100	100

Source: DCS: Census of Industries 1983 and unpublished data for 1996.

enterprises. It has the advantage of analysing the status of SMIs across different time points i.e., 1981 and 1996.

National Strategy for the SME Sector in Sri Lanka

Industrial Distribution of SMIs

46. The distribution of SMIs across industries at the two-digit level⁵ is given in Table 2.2. An overwhelmingly large proportion of these establishments are found to be concentrated in three groups of industries – viz., (a) food, beverage and tobacco products, (b) textile, apparel and leather products, and (c) mining. Nearly 75 per cent of SMIs were to be found in these sectors in 1996, accounting for nearly 80 per cent of all SMI employment. This pattern is almost identical to what prevailed in 1983, which suggests that the SMI sector has experienced limited diversification in the last two decades. This is another sign of the lack of dynamism in this sector.
47. Concentration in a few industries is not, however, a feature that is unique to SMIs. The whole of the industrial sector in Sri Lanka, including large-scale industries, happens to be concentrated in a few types of activities. Much has been written on the potential dangers of this failure to diversify. There are, however, some notable differences between SMIs and large-scale establishments in their relative importance across industries. The small-scale sector is especially predominant in the mining sector (Table 2.3). Their share of employment is 82 per cent in mining and 41 per cent in non-metallic mineral products, which are way above their overall share of 19 per cent in industrial employment as a whole. Other industries in which the small sector's share of employment is significantly higher than its overall share are wood and wood products (49 per cent) and food, beverage and tobacco products (33 per cent). These may be identified as the industries in which the small-scale sector is relatively more prominent. By the same criterion, medium-scale enterprises are relatively more visible in food and beverage, chemical and related products, and basic metal products. The large-scale sector is most predominant in the broad groups of textile, apparel and leather products and 'other manufactures', followed by paper and paper products. It would thus appear that at least to some extent small, medium and large scale industry groups specialize in selected sub-sectors of manufacturing although all three groups can be found to coexist in almost all branches of industry.

Table 2.2
Distribution of SMIs by Type of Industry: 1983 and 1996

Type of Industry (2-Digit level)	Establishment		Employment	
	(%)	(%)	(%)	(%)
	1983	1996	1983	1996

⁵ The International Standard Industrial Classification (ISIC) defines industry groups business establishments at different levels of disaggregation i.e., 2-digit, 3-digit, 4-digit level etc. Accordingly, 2-digit level classification deals with too broad industry groups while 4-digit level classification is more clear and specific in defining industry sub-groups.

Mining	11.6	12.5	9.0	6.9
Food, beverage and tobacco products	35.5	33.7	36.8	38.4
Textile, apparel and leather products	19.8	19.3	23.4	24.2
Wood and wood products	7.3	7.3	6.1	5.2
Paper and paper products	2.2	2.3	2.4	2.1
Chemical, petroleum, rubber & plastics	5.8	6.4	7.4	8.0
Non-metallic mineral products	12.1	12.3	8.9	9.2
Basic metal products	0.06	0.08	0.09	0.27
Fabricated metal products, etc.	4.3	4.5	4.7	4.2
Manufactures n.e.s.	1.4	1.7	1.2	1.4
Total	100	100	100	100

Source: DCS: Census of Industries 1983 and unpublished data for 1996.

Table 2.3
Share of SMIs by Type of Industry: 1996

Type of Industry (2 – Digit level)	Establishment (%)			Employment (%)			Value-added (%)		
	Small	Medium	Large	Small	Medium	Large	Small	Medium	Large
Mining	99.0	0.8	0.2	82.3	3.2	14.5	45.8	12.9	41.3
Food, beverage and tobacco products	85.0	13.4	1.6	32.7	39.2	28.1	5.0	21.6	73.4
Textile, apparel and leather products	77.0	12.8	10.2	9.1	9.8	81.1	5.5	8.5	86.0
Wood and wood products	94.2	4.8	1.0	49.0	16.0	35.0	33.6	44.8	21.6
Paper and paper products	85.2	10.4	4.4	16.7	15.1	68.2	9.6	19.3	71.1
Chemical, petroleum, rubber & plastics	75.0	18.5	6.5	11.2	26.8	62.0	4.1	20.6	75.3
Non-metallic mineral products	90.1	8.9	1.0	40.6	21.9	37.5	6.1	7.7	86.2
Basic metal products	38.5	46.1	15.4	3.9	48.1	48.1	1.3	39.6	59.1
Fabricated metal products, etc.	83.0	11.1	5.9	13.5	20.4	66.1	3.7	21.1	75.2
Manufactures n.e.s.	79.3	7.0	13.7	6.4	6.4	87.3	2.5	15.0	82.5
Total	85.4	10.7	3.9	18.7	17.6	63.7	4.9	14.7	80.4

Source: DCS, unpublished data.

Employment Generation

48. SMIs have made an important contribution to employment. In general, SMIs are more labour intensive than their larger counterparts. In 1991 the number of people engaged in SMIs was 15 per cent of the total number employed in the industrial sector, this increased to 23 per cent in 1997. Of the 23 per cent that were employed, 22 per cent were engaged in the manufacturing sector. Based on the total number of people engaged in the manufacturing sector, 41 per cent were in the food beverages and tobacco sector while 31 per cent were employed in the textile and wearing apparel industry. Other evidence is also available; for example the 1994 mission statement of the International Labour Organisation (ILO) reported that 75 per cent of Sri Lanka's labour force was employed in the small-scale sector (including the agricultural sector)⁶.
49. Even though SMIs account for a significant amount of employment creation, there is also a high turnover rate. The 1997 World Bank survey highlighted that within 8 years of receiving an SMI loan only 20 per cent of the SMEs survived. Nevertheless, SMEs play an important role in job creation; this is evident from Table 2.4, which captures the employment generated by micro (<10 persons) and SMEs (10-99 persons) as published by the DCS. The lack of data especially for 1994 and 1995 hinders specific interpretation, but indications are that SMEs continue to play an important role in employment creation in Sri Lanka.

Table 2.4
Number of Persons Engaged in Micro and SMIs, 1992-1997

Size	Persons engaged		1993		1996		1997	
	No:	%	No:	%	No:	%	No:	%
<10	2,911	1	3,002	1	46,995	9	48,225	10
10-99	44,406	15	48,389	14	119,146	22	113,408	23
Total	292,736		345,036		536,913		495,355	

Source- DCS – Annual Survey of Industries

Value Added

50. SMIs also made a significant contribution to Value Added but this is somewhat smaller than their employment contribution. SMI's industrial sector value added contribution for 1996 and 1997 was 13.4 per cent and 14 per cent respectively. In 1997, the highest Value Added for manufacturing was recorded in the Food, Beverages and Tobacco sector

⁶ ILO, 1994, "Sri Lanka: Employment Promotion and the Development of Micro and Small Enterprises," ILO-SAAT: New Delhi.

followed by the Textile, and Apparel industry, which amounted to 52.3 per cent and 13.6 per cent respectively.

Regional Distribution

51. Another important feature of the structure of SMIs is its geographical concentration. It is well known that most industrial establishments in Sri Lanka are concentrated in the Western Province and in particular in two districts of this province – namely, Colombo and Gampaha. Table 2.5 below confirms this picture. It is notable, however, that the extent of geographical concentration is more severe for the larger size groups. Thus, while 82 per cent of the large-scale establishments were located in the Western Province, the corresponding figures for the medium and small groups were 52 and 28 per cent respectively. Thus, SMIs would appear to be somewhat more dispersed regionally than the large-scale sector, but there is still considerable concentration among the SMIs too. Actually, most of their dispersion extends only as far as the neighbouring Central Province, and especially to the Kandy district of this province. Together the Western and Central Provinces house over 70 per cent of all medium scale industries and over 50 per cent of all small-scale industries. Among districts, three of them — Colombo, Gampaha and Kandy — account for 55 per cent of all medium scale industries and 37 per cent of all small-scale industries.

Table 2.5
Geographical Concentration of Industries by Size: 1996

Province/District	Establishment (%)			Employment (%)		
	Small	Medium	Large	Small	Medium	Large
Western	27.7	52.2	82.4	25.2	55.7	84.3
Colombo	9.2	32.7	46.0	9.4	32.3	44.7
Gampaha	13.2	13.9	34.0	10.6	18.3	37.7
Kalutara	5.3	5.6	2.4	5.2	5.1	1.9
Central	25.0	18.8	3.8	24.2	16.0	4.0
Kandy	14.1	7.4	2.6	13.9	6.2	2.9
Matale	4.4	2.8	0.5	5.5	2.2	0.5
Nuwara Eliya	6.5	8.6	0.7	4.8	7.6	0.6
Southern	11.1	7.6	4.2	12.8	8.8	2.7
Galle	6.3	2.7	2.0	3.2	3.2	1.4
Matara	3.7	4.4	1.5	4.9	4.9	0.6
Hambantota	1.1	0.5	0.7	0.7	0.7	0.7
North Western	13.7	7.6	4.4	15.8	6.4	3.5

Kurunegala	7.3	3.1	2.9	9.7	2.2	2.3
Puttalam	6.4	4.5	1.5	6.1	4.2	1.2
North Central	2.3	0.6	0.4	2.7	0.5	0.2
Anuradhapura	1.3	0.3	0.4	1.4	0.3	0.2
Polonnaruwa	1.0	0.3	0.0	1.3	0.2	0
Uva	7.3	3.9	1.3	6.3	3.3	1.4
Badulla	5.6	3.6	0.6	5.3	3.1	0.3
Moneragala	1.7	0.3	0.7	1.0	0.2	1.1
Sabaragamuwa	12.8	9.2	2.9	12.9	9.0	3.7
Ratnapura	9.0	6.0	1.8	8.3	6.0	1.5
Kegalle	3.8	3.2	1.1	4.6	3.0	2.2
Sri Lanka	100	100	100	100	100	100

Source: DCS, unpublished data.

Earnings of SMEs

52. As stated earlier, existing data bases provide limited information on SMEs operating in agriculture and service sectors of the economy. Of various studies undertaken to give an indication of the average earnings for SMEs, two studies deserve special mentioning. First, a survey carried out by the Central Bank of Sri Lanka in 1998, which found that the annual turnover of SMEs varied from Rs 523,904 in non metallic products to Rs. 95,000 in basic metal product industries. Secondly, a survey undertaken by the Small and Medium Enterprise Development Project (SMED)⁷, involving a sample of 1328, which indicated that the average turnover per employee was Rs 231,000. This same survey revealed that the average sales turnover for 1996 was Rs 10 million. Further, the SMED survey highlighted that between 1991 to 1996, there had been a decrease in export orientation in terms of turnover from 16 per cent to 8 per cent respectively. However, further data will need to be collected on a regular basis to obtain a more accurate picture. Two studies are particularly reliable.

Recommendation 3

Reliable statistics relating to SME activities to be collected on an annual basis with sufficient detail to be useful for analysis and policy prescription.

⁷ SMED, 1998, Study on the Impact of Liberalization of the Economy on Small and Medium Industries in Sri Lanka. SMED: Colombo.

International Business Environment

53. The international context in which Sri Lanka SMIs carry out business has changed significantly in recent years. Sri Lanka's open market policy, the Indo Lanka Bilateral Free Trade Agreement, Sri Lanka – Pakistan Bilateral Free Trade Agreement, pending SAARC Free Trade Area and WTO commitments are just a few examples of how the domestic market is being shaped by international events.
54. At the national level, Sri Lanka has moved rapidly down the path of economic liberalization and improved its competitiveness. Specifically, it has revised and progressively lowered tariff barriers and has made efforts to deregulate industry and trade. Despite major macroeconomic problems, political turmoil and government changes, market-oriented reforms have been sustained since 1977 and as a result Sri Lanka today stands out as one of the most open economies in the world. The pro-market policy regime is now a bipartisan policy in Sri Lanka. It has also devolved power and decision making from central government to Provincial Councils.
55. At the international level, production systems are increasingly organised across international boundaries and capital has become highly mobile. Moreover, convergence of regional trade agreements and the continuing decline in barriers to trade across a wide range of products and economies continue unabated. One response by firms has been to create strategic alliances and develop networks. A second aspect is for production and trade to become more automated and computerised with e-commerce representing the leading edge. For Sri Lanka's SMEs, as for many enterprises, this offers both opportunities and challenges.

2.2 Defining what is an SME

56. Sri Lanka does not have a nationally accepted definition for small and medium enterprises. SMEs have been variously defined in terms of either value of fixed assets, the size of employment or a combination of the two. Different institutions define SMEs on the basis of their assistance programmes. The IDB defines its target beneficiaries as those with a capital investment of less than Rs. 4 Million. The Department of Small Industries defines SMEs as those with a capital investment of less than Rs. 5 Million, and which employ less than 50 employees. The National Development Bank defines SMEs as those with a capital investment of

less than Rs. 20 Million excluding land and buildings. The Export Development Board defines SMEs as those with a capital investment of less than Rs. 20 Million in plant, machinery and equipment excluding land and buildings and an annual export turnover not exceeding Rs. 40 Million and total annual turnover not exceeding Rs. 100 million. None of these definitions however, give a demarcation between Small Scale and Medium Scale enterprises.

57. International experience however, reveals use of a variety of working definitions depending on country specific objectives. By and large, these definitions are based on three main criteria: a) number of full-time employees, b) turnover or production and, c) total assets value.
58. The problem with defining a small industry on the basis of the size of capital is that the cut-off point needs to be revised over time in order to allow for inflation. However, inconsistencies arise in the process of doing so, because not all firms revalue their capital in a uniform manner. Defining SMEs by the number of employees has also been widely used. This method is usually straightforward, but can also face some problems due to factor intensity of different industries. Moreover, part time workers and family workers, who function both as managers and workers, create some definitional problems. In Sri Lanka, when measuring size by employment the following definitions are often used: micro <5 employees, small 5-29 employees, medium 30-149 employees, and large 150 employees and above⁹.
59. An additional problem with any SME definition is that it must serve a multiple of functions. At a theoretical level it must define SME as being conceptually different from large. That is, SMEs are assumed to have characteristics (other than their size) that identify them as being different from large enterprises. It is on the basis of having different characteristics and, therefore different requirements, that specific SME policies are advocated. At a practical level, a definition must be easy to implement in terms of gathering accurate and useful data. At a sectoral level, financial institutions often need different data than national surveys or government institutions require. Such diversity however, can be overcome by first redefining conceptual differences by notional demarcation between sizes based on experience. Further flexibility can be built into the definitions by adopting two systems of defining SMEs. One could be based on employment and the other on size of capital in real terms. A system of using more than one definition is found in many countries, including Indonesia and the Philippines. For example, in the case of the Philippines, the asset value for small-scale enterprises is in the range of US \$ 30,000

⁹ However, in the World Bank evaluation of Business Sector Enterprises in 1997, a small enterprise was defined to include 1-49 workers, a medium enterprise with 50-99 and a large one more than 100 workers.

to 300,000 pesos as against US \$ 300,000 to 1,200,000 pesos for medium scale enterprises. In terms of number of employees it is in the range of 10 to 99 workers and 100 to 199 workers for small and medium enterprises respectively. In Singapore, a small and medium size enterprise is defined as a company with at least 30 per cent shareholdings and less than \$ 15 million in fixed productive assets. For the service sector enterprises, it must have less than 200 employees.

60. Having considered international experience and various definitions adopted by different institutions in Sri Lanka, the Task Force agreed to define SMEs¹⁰ based on **assets values not exceeding Rs. 50 Million excluding land and buildings**. This value is to be adjusted for inflation once in five years based on the implicit GDP deflator. The Task Force also agreed to give a demarcation between Small Scale and Medium Scale enterprises based on asset values (excluding land and buildings) i.e., asset values not exceeding **Rs. 20 Million** for small scale enterprises and **Rs. 50 Million** for medium scale enterprises. At the lowest end, the required asset value for a small-scale enterprise was set at Rs. One Million. The term 'enterprise' in this context is defined to include any business activity or enterprise engaged in industry, agri-business and/or services whether single proprietorship, partnership or corporate venture.
61. The selection of the above definition is primarily based on two considerations: a) wider usage of investment based criteria by key institutions involved in SME development (i.e., IDB, EDB and the Department of Small Industries), and b) preference shown by bankers and others engaged in providing funding support. It also has the added advantage of reflecting price changes at national level on a periodic basis. The definition based on employment was not preferred primarily due to problems associated with existing labour laws and regulations e.g., under-reporting of employment and use of casual labour. It is also distorted by factor intensities of different sub-sectors in industry.
62. Whatever definition is adopted, there are other problems in obtaining a reliable and comprehensive profile of the SME sector. The problems are of two kinds. First, published data on the industrial sector have been at too aggregative a level to isolate the profile of SMEs, as instanced by the Annual Surveys of Industries carried out by the Department of Census and Statistics (DCS). Secondly, while some information can be extracted for the industrial enterprises¹¹, there is virtually no information on the size and structure of SMEs in the agriculture and services sectors.

¹⁰ The term "Small and Medium Enterprises" (SMEs) covers formal sector business activities only and hence issues relating to the informal sector activities are not covered in the present White Paper.

¹¹ For example, Management Information Division of the MEDIPIP.

Recommendation 4

The definition recommended by the Task Force is to be used as a standard for data collection, policy analysis and implementation of SME sector development programmes.

2.3 Constraints facing SMEs

63. Several surveys have been undertaken to investigate the problems facing SMEs. Over a substantial period of time multilateral and bilateral agencies such as USAID, World Bank, JICA, ADB, UNIDO and many others, have worked on the problems of SMEs in Sri Lanka. In addition, ongoing work by local NGOs such as SMED, Sarvodaya etc., also deal with a wide range of issues relating to SMEs. Government Ministries have also carried out their own studies and programs as well as working in close cooperation with multilateral and bilateral organisations.
64. In addition to the stock of information available from the above sources, the experience of **Public Hearing Workshops** conducted as a part of the consultative process of the White Paper, served as a major source of information in analyzing the problems faced by SMEs. More specifically, the public hearings conducted at Kandy, Matara, Colombo, and Trincomalee provided most comprehensive and up-to-date information representing the experience of entrepreneurs, Chambers, NGOs, government and semi-government organizations and Provincial Councils. From these sources, it is possible to draw a clear picture of what most entrepreneurs in the SMEs sector see as the constraints they face. The following are high priorities identified by SME sector entrepreneurs and various agencies mentioned above.
65. **Policy inertia** is one of the most important factor that has constrained the growth and development of SMEs. In spite of various policy reforms over the last few decades there hasn't been any deliberate policy framework to build up a vibrant, efficient and competitive SME sector in Sri Lanka. For example, the economic policy reforms introduced by successive governments during the post-1977 period repeatedly emphasized the significance of export-oriented foreign direct investment (EOFDI) with attractive incentive packages. As a part of this strategy, investment and trade liberalization was given high priority in policy reform agenda in the 1980s and 1990s. The establishment of the BOI as a 'one-stop shop' to help large firms in obtaining administrative clearance and infrastructure support was yet another major policy initiative during the post-

liberalization period. The end result however, was the presence of two policy regimes, BOI and non-BOI, with discriminatory policy support and incentives for BOI firms. Among the non-BOI sector firms, large-scale export oriented firms were relatively in a better position due to the heavy emphasis placed on export-led growth strategies by the post-1977 policy regime. In this policy reform process the SMEs however, were left with ad-hoc policy prescriptions and weak institutional support.

66. Undoubtedly, liberalized economic policies have created opportunities for growth and expansion for some sub sectors of SMEs but, it has adversely affected others. Even when opportunities have been created, SMEs have not been able to draw the full advantage due to lack of appropriate policy support. This has been attributed partly to the failure to take into account local socio-economic realities in formulating the structure and pace of policy changes and partly to the problems in implementation. Moreover, the structural adjustment policies during the post-liberalization period did not prove to be neutral, and did not ensure a level playing field for small producers. In the context of developing countries however, SMEs are at a disadvantage in terms of having access to credit, information, technology and markets.

67. Of the constraints identified, **high interest rates and the emphasis on collateral** by lending institutions are the most frequently cited constraints affecting SME development. In spite of the massive efforts made by state owned banks and other development financial institutions to assist SMEs over the past four decades, access to credit and cost of funds stand as the most important constraint on SMEs. As noted during the public hearings, there seem to be a favourable bias towards large-scale enterprises in providing credit by financial institutions. This implies a high degree of severity to financial constraints in respect of SMEs as against the large-scale enterprises. A survey carried out by the Central Bank revealed that 61 per cent of the entrepreneurs stated that bank borrowing was difficult, and that difficulties in furnishing collateral or guarantees by banks was one of the major problems facing the SME sector. This was followed by high interest rates and inability to repay loan installments on time. As a result, SMEs have to pay higher interest rates than their larger counterparts due to the higher risk of default associated with these types of firms. The request for land based collateral by banks as a basis for granting of loans is also another constraint to setting up efficient and productive enterprises. Lack of regional spread of loans is yet another financial constraint faced by entrepreneurs operating outside the Districts in the Western Province (Table 2.6).

Table 2.6 District-Wise Distribution of Loans under SMI I to SMI IV
(As of March 27, 1998)

District	No. of Loans	Percentage of No. of Loans	Percentage of Value of Loans
Ampara	34	0.3	0.1
Anuradhapura	676	4.3	2.5
Badulla	449	2.9	1.7
Batticola	30	0.2	0.1
Colombo	3648	23.5	33.9
Galle	903	5.8	5.9
Gampaha	1871	12.1	14.2
Hambantota	310	2.0	1.4
Jaffna	60	0.4	0.2
Kalutara	610	3.9	4.9
Kandy	1123	7.3	4.4
Kegalle	404	2.6	1.8
Killinochchi	-	-	-
Kurunegala	1830	11.8	7.9
Matara	946	6.1	5.7
Mannar	6	-	-
Matale	363	2.3	1.5
Moneragala	108	0.7	0.5
Mullativu	3	-	-
Nuwara Eliya	230	1.5	1.4
Polonnoruwa	394	2.5	2.0
Puttalam	990	6.4	7.2
Ratnapura	439	2.8	3.2
Trincomalee	74	0.5	0.4
Vavunia	10	0.1	-
TOTAL	15511	100.0	100.0

Source: Central Bank of Sri Lanka, (n.d.)

68. The **low level of technology** and **absence of technical and managerial skills** have also been identified as important constraints affecting SME development. The level of technology is directly related to the operational efficiency of SMEs. Lack of technological applications have severely constrained the SMEs' ability to face competition from both local and foreign products/services. In many instances, the use of technology levels tends to be low, and is not frequently available for rural-based enterprises. In this regard, state-owned Science and Technical institutions including Universities have failed to establish links with SME sector enterprises and address their technical problems. Moreover, lack of skilled labour has further weakened the technical capabilities of SMEs. Even though there

have been various institutions set up (IIT, IDB, NSC, Technical Colleges etc.) to provide training, the quality of training is inadequate and mostly supply driven.

69. **Lack of market information and marketing skills.** – SMEs find it difficult to expand their markets and exploit available market opportunities due to the lack of information on domestic and international markets. They also lack skills on product development, packaging, distribution and sales promotion. Similarly, SMEs lack the necessary market information and business advice on niche markets that may generate profitable business ventures.
70. **Lack of adequate infrastructure facilities.** - Enterprise success is dependent on the availability of key infrastructure services such as electricity, water, telephones and road access. Many firms in the rural areas do not have access to some of these basic facilities. This prevents firms from using the necessary equipment to improve the quality products and ensure easy access to markets for finished goods. With respect to electricity especially, SMEs are adversely affected by high cost of power (in obtaining power connections and paying high tariffs) and unreliable service.
71. The other factor that constrains SME development is the **current labour legislation**, for example, the Termination of Employment of Workmen's Act (1971) Act, the Industrial Disputes Act and some others. The objections raised against the Termination of Employment of Workmen's Act (1971) is that it serves to reduce demand for labour and hence acts as a break on employment generation. Further, it is alleged that this particular Act and the job security that is provided by the Act, generates negative effects on work ethic and productivity. There is reluctance of the part of employers to hire workers, as terminating their employment would prove costly in terms of time and money¹². On the other hand, it also has effects on productivity as it increases worker shirking. The labour laws encourage the use of temporary workers, which may impact negatively on productivity as temporary workers require less specific skills. The Industrial Disputes Act sets out the principal mechanisms through which disputes are settled. In Sri Lanka, conciliation is the method most widely used for settling disputes. The major problem with this approach is that the Industrial Relations Division of the Ministry of Employment and Labour lacks sufficient cadres of trained and experienced Labour Officers to conciliate and mediate between the two parties. This is particularly relevant for SMEs as the entrepreneurs do not have time for lengthy legal disputes.

¹²This could be on the grounds of retrenchment due to a firm's restructuring, and a mismatch between the hired workers and their job demands.

72. Many of the industrialists during public hearings expressed the view that **competition from low priced sub-standard goods** present a serious threat to SME development. This, together with leakages from BOI Bonding Houses are perceived as a threat to the growth and development of SMIs. A paper by the National Chamber of Commerce in Sri Lanka, highlights that there is discrimination by state institutions against SMEs in their purchase of local supplies, where the government agencies prefer to buy low quality imported goods as against products made available by SMEs.
73. Of the constraints identified, the **regulatory role of the government** is yet another constraint affecting SME development. In spite of more than two decades of pro-market policy experience, there exists an overly bureaucratic system that often results in unnecessary delays in its deliberations and is excessively costly. This includes a complex system of documentation, lengthy procedures and outdated rules and regulations.

PART THREE

Objectives and Principles for a National Strategy

74. This part of the White Paper details the components of a coherent integrated national strategy based on the analysis of the previous two parts of the Paper. In the first part of the White Paper the role of the Task Force and a vision for the SME sector was described. In doing so, the White Paper established a long-term goal for the SME sector. This was followed by part two which set out the characteristics of the sector and constraints and past policies faced by entrepreneurs. Based on these two parts, it is now possible to focus more precisely on the objectives for a SME strategy.
75. The SME strategy must provide a systematic and comprehensive framework for various policy initiatives and programmes at the national and regional level, as well as across all industry and service sectors. In addition to macroeconomic imbalances, such a strategy must also take account and incorporate the role of multilateral and bilateral programs. Furthermore, such a strategy needs to be transparent and rational in utilizing scarce resources. This requires prioritising policies, initiatives and programs.

3.1 Objectives of the National SME strategy

76. The most important objective of the national strategy is to **create an enabling environment for SMEs in Sri Lanka**. Under the right conditions, entrepreneurs of SMEs will increase in number and the size of their enterprise will expand. Moreover, the creation of an enabling environment makes the best use of scarce resources because it effects a very large number of SMEs and provides high returns on the government's development efforts.
77. Coordination between a range of Ministries, regional authorities and local agents will be necessary to achieve the national strategy objective. Also, it will require the strategy to be integrated into national policy in other sectors. For example, a national integrated strategy for SMEs must be coordinated with sectors such as education, labour, tourism, trade and commerce and regional planning, to name but a few.

-
78. The objectives of an integrated national strategy for SMEs also imply that it fits with the overall thrust of economic policy. Since the late 1970s Sri Lanka has been liberalising its economy. It moved early on to liberalise its trade regime and is currently poised to liberalise further its factors of production — land, labour and capital.
79. Table 3.1 sets out several other key objectives that can be identified as part of a coherent integrated national strategy. Each strategy is elaborated in the paragraphs following Table 3.1.

Table 3.1
Key Objectives of a Coherent Integrated National Strategy

-
1. Create an enabling environment for SMEs in Sri Lanka to meet the challenges of an internationally competitive economy
 2. Stimulate economic growth
 3. Facilitate competition and cooperation among entrepreneurs
 4. Foster long term quality employment
 5. Improve income and wealth generating opportunities for low-income groups
 6. Minimize the imbalance between large-scale enterprises and SMEs
-
80. **Prepare SMEs to meet the challenges of an internationally competitive economy.** A key consideration in creating a conducive business environment is the need for domestic SMEs to be able to compete against imports or enter international markets. Under an increasingly liberal trade regime and deregulated global economy it is necessary for SMEs to be internationally competitive. In many cases domestic SMEs have an inherent advantage operating in the domestic economy. The cost of transport and the regulatory requirements for imports means that small local firms at the site of their market have a natural advantage. This is particularly true for products that have a high ratio of transport cost to unit cost. It is also true for local firms producing perishable goods and located close to their markets.
81. Such an advantages needs to be enhanced through the creation of an enabling environment. The recent development of a national cleaner production strategy is an example of how government agencies can improve the international competitiveness of SMEs. By applying clean production techniques, businesses are better able to make use of existing resources. In some cases, being certified as using cleaner production provides greater access to international markets.

82. **Stimulate economic growth.** SMEs are a key part of the national economy. In the earlier parts of this report it was estimated SMEs provided a significant contribution to GDP. At an individual level, SMEs provide goods and services for a large part of the population. Moreover, SMEs respond quickly to growth-oriented initiatives by creating employment opportunities and income generating activities in different sub-sectors of the economy.
83. **Facilitate competition and cooperation among entrepreneurs.** Competition is beneficial both to the SME sector and consumers. Strong and fair competition creates industries that can withstand sudden change. It also reduces costs of production, which benefits consumers and enhances overall productive efficiency of the national economy.
84. **Cooperation** among small businesses should also be encouraged. Clusters of small businesses working closely together can overcome the size disadvantage. There is now an extensive literature on the advantages of clustering with case studies from Germany, Italy, Indonesia, Brazil and many other countries¹³. Both competition and cooperation require a stable and predictable business environment.
85. **Foster long-term quality employment.** A key contribution made by SMEs is the substantial number of people employed across all districts of Sri Lanka. In particular, SMEs employ a significant number of workers outside the Colombo region. One challenge for SMEs is to improve the quality of their employment. A crucial component for improving workers' conditions and remuneration is increasing the skill levels and strengthening the use of appropriate, modern technologies.
86. **Minimize the imbalance between large-scale enterprises and SMEs.** In the past, market opportunities, regulations and competitive structures have favoured large enterprises and those located in the major urban centres, particularly those in and around Colombo. Therefore, an objective of a coherent integrated national strategy will be to redress these discrepancies. Moreover, the aim will also be to maximise the cooperation between large-scale enterprises and SMEs. Such cooperation should be encouraged based on a principle of mutual advantage for large and small enterprises.
87. **Improve income and wealth generating opportunities for low-income groups.** It is now widely recognised by multi and bi-lateral agencies that the promotion of SMEs is an effective strategy for reducing the incidence of poverty and improving opportunities for wealth and income generation

¹³ In Sri Lanka cluster studies have been initiated by the USAID and at present, there are five different cluster studies in progress e.g., Tea, Rubber, Plastic, Information Technology and Gems and Jewellery.

among low-income groups. Therefore, an important objective in promoting national development and a just and equitable society is to increase the opportunities available to low-income groups for improving their conditions.

88. To carry out the above objectives of the national strategy for SMEs, there must not only be a Ministry identified and dedicated to implementing it, but there should also be a capacity within this Ministry for the planning and implementation of such a strategy. Thus, the key implementing Ministry would have to develop that appropriate analytical and policy capacity.

3.2 Making the national strategy operational

89. Having established a vision and the objectives it is now possible to consider the process of implementing the strategy. Such a process requires time and must also be an inclusive process covering all stakeholders. Also important, as shown by international experience, is the need for strong leadership by national strategists. The following steps outline the process of strategy formulation and implementation.
90. **Building awareness and national consensus.** A significant first step in the process, is building awareness and a national consensus as to what is required and who should take leadership. Such awareness and consensus must be built across a number of stakeholder groups, including entrepreneurs, Chambers of Commerce and Industry, members of the academia, civil servants, politicians and unions. The process of formulating this White Paper was a beginning and building awareness and consensus is the second step. This process of awareness and consensus building will need to continue during the period of implementation.
91. **Implement specific action programmes given under each strategic element.** The responsibility of implementing specific action programmes given in the White Paper rests primarily with the key implementing agency — The Ministry of Enterprise Development, Industrial Policy and Investment Promotion. In operational terms, this is the responsibility of the proposed SMEPU/SMEA functioning under the supervision of the MEDIPIP. This involves strengthening of cooperation between agents and improving coordination and networking between various stakeholders engaged in SME development. This is a challenging task and it requires strong leadership and staffing of highly skilled and result oriented personnel at SMEPU level.

3.3 Fundamental principles

92. In implementing a national strategy and working in partnership with international agencies, donors, NGOs, Chambers of Commerce and Industry and other stakeholders, there are a number of underlying principles that involve the action of the government. These principles are briefly covered here with a view to providing a general guide for the government to involve itself effectively in the development of the SME sector.
93. **The SME sector represents a significant social and economic part of Sri Lankan society.** Not only do SMEs make up a substantial part of the economy, their entrepreneurs and their workers play an important part in the social fabric of Sri Lanka. An important corollary is that it is crucial to improve skills and the use of appropriate technology. This will improve the lives of entrepreneurs, their families and workers. The government also recognises that the SME strategy must be consistent and part of a wider strategy for the entire Sri Lankan economy.
94. **The SME sector represents a diverse range of industry and service sectors, sizes and geographical locations.** The SME sector represents a very heterogeneous group of activities with different characteristics and needs. They are widely distributed across different sub-sectors of the economy with high degree of variation in terms of size and geographic locations. Among these diverse set of enterprises some are rapidly expanding while many others are in survival mode or on the verge of collapse. The latter is highly sensitive to fragile macroeconomic conditions and political uncertainty at national level.
95. **The market system represents the most efficient means for achieving progress.** Despite the occurrence of market failure and market distortions at the international and national level, there is a belief in the government that the market mechanism provides the most efficient means of allocating resources. Within the market mechanism, entrepreneurs are crucial decision makers and should be empowered to allocate resources within a clear, stable and transparent framework. In creating such a framework a crucial role should be played by private public-partnerships.
96. **Delivery of Business Development Services (BDS) needs to be demand driven.** In line with best practice principle established by international donor agencies, it is accepted that BDS need to be led by SMEs' demand. Such services must also be of real benefit for SMEs. It is therefore important for BDS to be delivered on a 'for fee' basis. This will allow suppliers to respond to market signals and SMEs to indicate their preference through purchases. It is also accepted that generally, private

businesses are more suited to responding and delivering BDS. Where the government does deliver BDS, it should be guided by demand-driven considerations such as high quality, efficiency and market prices.

97. **Lessons can be learned from international experience.** In the delivery of SMEs' policies there exists a wide range of international experience that can enrich Sri Lanka's policy experience. In many cases, there are well-recognised best practices that can be suitably modified to fit Sri Lanka's unique experience. Given that the government allocates scarce resources for SMEs' programs and policies, international best practice provides guidelines for such allocations.

Table 3.2
International Best Practice - Taiwan SME Experience

Characteristics of SMEs in Taiwan

1. Entrepreneurial spirit
2. Flexibility and speed
3. Specialization and cooperation
4. Industrial cluster effect, and
5. Mutual trust

Directions for guiding SMEs in Taiwan

1. Improving the operating environment for SMEs
2. Promoting mutual cooperation among SMEs
3. Assisting SMEs to strive for growth with their own efforts

Source: Export Orientation for Small and Medium Enterprises, Asian Productivity Organization, 2001.

98. **The government plays an important role in the SME sector.** The primary role of the government in the SME sector is one of facilitation rather than direct intervention. A facilitating role exists both in creating a regulatory environment conducive to business and in the delivery of BDS and finance. Such a role is played by all levels of government with pro-business orientation and supported through on going public sector reforms. One important aspect of creating an enabling environment includes the removal of 'unnecessary' legislation and regulations. In general, the regulatory environment needs to be transparent, predictable, stable and consistent, and timely in implementation. Overall, the economic environment, comprising policies, regulations and institutions needs to engender an environment of trust in which businesses can compete and cooperate. Similarly, the government can encourage the private sector, through market-based incentives and the regulatory framework, delivery of BDS and credit targeted at SMEs.

99. **Private sector institutions, NGOs and Donors play an important role in implementing a national vision and strategy for SME development.** The government recognises that for an effective strategy there is an important role to be played by a range of agencies outside of the government. The implementation of a national strategy will require the cooperation of Chambers of Commerce and Industry, NGOs and donor agencies. Partnerships and networks will need to be developed and strengthened in achieving the vision for the SME sector.

PART FOUR

Enabling Business Environment

100. This part of the White Paper focuses on the supportive framework that is vital for SME development. The purpose is to build up competitiveness of SMEs within the small open economy of Sri Lanka. It primarily deals with ten major areas of business support: a) Finance, b) Technology, c) Access to information and markets, d) Business development services, e) Linkage formation, f) Infrastructure, g) Legal and Regulatory framework h) Industrial relations and labour, i) Entrepreneurship skills, and j) Environmental issues. The analysis and recommendations of these issues are based on a policy, which advocates “maximum support but minimum intervention” on the part of the government. Under this policy, the government does not interfere directly in the market, but provides a favourable business environment and infrastructure facilities. The government’s role is seen as a facilitator, working closely with other stakeholders - the private sector, NGOs, and the donor community- playing a dominant role in designing and delivering services. It is also important to note that creating an enabling business environment is not a task that the MEDIPIP alone can accomplish. It requires intra and inter-ministerial co-ordination, co-ordination with private sector institutions, NGOs and the donor community as an integral part of the implementation process.
101. The required institutional support system for effective delivery of these services is spelt out in Institutional Support System (Chapter 5) and Action Plan (Chapter 6). This involves establishment of a highly powerful SME Policy Unit (SMEPU) as an interim measure and setting up of a SME Authority (SMEA) under a separate Act of Parliament.

4.1 Access to Finance

102. Problems related to finance were identified as the foremost affecting SMEs. This broadly includes four sub-sets of problems: a) availability of funds and other credit instruments, b) access to equity and loan capital, c) cost of borrowing, and d) management of finance. These problems are more serious for SMEs as they do not have access to other sources of finance such as the capital market. In addition, proprietorship, poor resource-base and inability to avail economies of scale have further weakened the financial strength of SMEs. The lack of opportunities and problems connected with finance implies use of

outdated technology, poor production facilities, absence of quality control, lack of market orientation and relatively low profitability. Hence, there is a vicious circle linking financial problems with the performance and progress of SMEs. Thus, in spite of the massive efforts made by State owned banks and other development financial institutions to assist SMEs over the past three and half decades, access to and cost of credit stand as the most important constraint on SMEs.

103. Among the four major sub-sets of problems, **availability of funds**, is partly related to certain inherent weaknesses of SMEs and partly linked with the under developed character of financial markets in Sri Lanka. The SMEs are mostly proprietary, partnership or private limited liability Companies. Thus, unlike larger Companies they cannot access Equity capital from Venture Capital Companies or easily get outside share holders to put in equity when needed. They, by and large are therefore compelled to resort to loans, and leasing. But in this too, they are hampered by lack of collateral. This is more so when additional working capital is required. In order to keep their enterprises operational they are then compelled go to the informal sector which is very costly, often leading SMEs to a debt-trap and finally, resulting in financial collapse.

104. With respect to remedial measures for increasing availability of funds, the idea of establishing a separate Development Bank for SMEs as a strategy to become more development oriented and reach the SMEs scattered over an extensive geographic area is confronted with cost effectiveness and recent developments in banking industry. For example, with the global trend of privatization even the two Development Banks were privatized. Following privatization and globally accepted regulatory regimes required for banking, these Banks in order to enhance their profitability and to lower the risk are moving more towards commercial and security based lending. Thus, establishing a new development Bank may therefore be not the answer.

105. It has also been noted that between 40 to 60 per cent of the cost of establishing an industry is incurred in acquiring land, building and infrastructure. Often there is no justification for a new SME to acquire these facilities with the meagre resources at its disposal. One way of reducing the need for funds therefore, is to make available developed land with infrastructure and preferably buildings too on long lease or rental basis. This could either be made available by the State or even private developers in the form of industrial estates. These estates could provide common services such as security, bonded stores etc., to enhance their own profitability.

106. As another remedial measure, the State has to encourage equity providers to SMEs. Such providers could be Venture Capital Companies, Fund Managers, or even private individuals. Legislative protection and incentives for such risk takers need to be provided. Legislative protection even for those investing on partnership basis must be provided. Legislative protection suggested are that such investments be regarded as personal liability of the main entrepreneur (like EPF liability) and quick and economical legal process to recover such investments. Additionally, the liability of partnerships too should be limited.
107. As a remedial measure, the banking and related sector should be encouraged to extend loans and other financial instruments to SMEs. Obviously, serving SMEs is costlier for them and such costs cannot be passed over to the SME sector too. However, considering the broad socio-economic benefits associated with SME development, the government should encourage the Banking and related sectors such as leasing, Factoring, Bill discounting Companies, by reducing the tax on profits on the lending to the SME sector.
108. Another recommendation relating to availability of funds refers to Credit Guarantee Schemes. It is widely known that after two decade of experience on Credit Guarantee Mechanisms of Central Bank and Donor Sponsored Credit Guarantees, banks have come to realise that credit guarantee in its current form is not a solution to credit risk and it merely increases the transaction cost. However, the viability of Credit Guarantee Schemes run on commercial principles is still valid. Therefore, it is recommended that the proposed SMEA should work with relevant private sector organisations to design new Credit Guarantee Scheme run on commercial principles. Proposed SMEA too should negotiate foreign and local funds and make them available to the banking and related sector to lend to SMEs.
109. The second, **access to funds**, is primarily due to lack of collateral. In a developing country such as Sri Lanka it is not many SME owners who will have the assets to provide the collateral. Neither can the Banks, who too are commercial enterprises, be called upon to risk their depositors' money. They are also burdened with heavy overhead costs. Even the land owned by SMEs is not bankable due to Title problems. In fact, the land market in Sri Lanka is virtually closed and the volume of business the land market generates is minimal for both private and state lands¹⁴. This has been attributed to the dualistic legal framework relating to state and private land and operational inefficiencies of regulatory institutions.

¹⁴ In 1985 the ownership of about 80 per cent of total land area of the country was vested in the state, the balance being owned by private individuals.

110. The lack of development orientation on the part of both commercial banks and development banks has also been cited as a factor relating to limited access to finance. As viewed by SME owners, Sri Lankan banking institutions are traditional and collateral conscious in their lending practices and hence, making the SME sector less attractive for credit support. The SMEs are also not in a position to prepare bankable project proposals for bank finance due to lack of knowledge and skills in project feasibility studies. In addition, as pointed out in section 2.3, the area-wise-outreach of existing banking institutions is inadequate to fulfil funding requirements of SMEs located outside the Western Province.
111. In order to overcome this problem, State Lands need to be leased out for minimum periods of 50 years and leaseholds made transferable. The Registrar of Companies requires mortgages of movables and immovables of Companies to be filed with him. This facility needs to be extended to Partnerships and Proprietorships and stricter rules applied so that movables too could have greater security for the lender. Industrial Estates referred to earlier should be encouraged to provide Bonded Warehouse so as to enable Banks to operate Pledged loan facilities.
112. Credit and advice are mutually inclusive factors in SME development. The latter refers to advice and guidance on project feasibility studies, project reports, technology and product quality, financial management, human resource development and marketing. Obviously, such services have to be provided by business development service (BDS) providers jointly with the bankers. Accordingly, disbursement of funds and allied facilities will be provided with the assistance of BDS providers, Management Companies so that they closely supervise the financial aspects of the SME thus securing the position of the Banks. The IDB has already initiated a somewhat similar arrangement and this should be developed and strengthened.
113. Legislative support has to be provided for the BDSs to play an active role in the management and supervision of SMEs. In return, there should be responsibilities cast on the BDSs, on specified criterion under an enabling legal provision.
114. The third, **cost of funds**, is yet another most cited financial difficulty faced by the SMEs. In the absence of concessionary funds earmarked to that sector, the lending has to be from the normal funds of the Banks. The relatively high spread ratios of commercial banks especially state owned banks have also been cited as an important causal factor for high interest rates¹⁵ in Sri Lanka. Added to this is the cost of operating the smaller loan components and perceived higher risk of lending to this sector, which pushes up the interest cost. This is further aggravated by the insufficiency of marketable collaterals that are furnished. The Task Force recognises that continued subsidised funding to any sector is not likely to come by within a pro-competitive policy regime. What is therefore

¹⁵ Refers to the interest rate spread between deposit rate and lending rate (IMF, International Financial Statistics).

- needed is to work towards reducing the margin paid by SMEs by improving their risk profile and to enable the SMEs to have greater access to the formal lending sector instead of the informal sector.
115. Insufficient working capital could also be viewed as a contributory factor towards high cost of funds. Banks are very reluctant to provide adequate working capital through a term loan and, as a result, a larger portion of SME's working capital requirements is often met through overdraft facilities and financing through post-dated cheques. As the cost of these types of credit is substantially higher, it is an additional cost burden for SMEs.
 116. The fourth, **Management of the finances**, has also been identified as a major problem faced by the SMEs. This could be attributed to several factors: a) insufficient equity base, b) high cost of finance, c) over ambitious business acceleration, d) lack of financial management experience, e) non separation of business and private expenditure, f) over expenditure on status symbols such as cars, offices etc., g) slowdown in the economy or market changes, and h) unexpected policy changes of the Government. Except the last two, the rest can be improved by installing proper financial discipline at enterprise level. Feasible options in this regard include training of SME owners in the elements of financial management and involvement of BDS service providers in disbursing loans, monitoring and following repayment. Both of these activities could easily be made as essential components of a loan programme and implemented as a package of assistance in SME development. Both the government and private sector organizations could also play an important role in stimulating and facilitating the delivery of such services.
 117. Another important issue which deserves special emphasis under finance is the existing **Loan Recoveries Act** commonly known as the **Parate**. It is alleged by SMEs that the existing Loan Recoveries Act is one sided and that some banks do not have the expertise or the mechanism to assist a sick enterprise which has the potential to recover. Hence, they resort to the easier path of using the provision of the Recoveries Act much to the disadvantage of the entrepreneur and the employees. The Task Force therefore, recommends that this law be amended and provision made for sick industries to be afforded an opportunity to reconstruct if possible. This however, should not be at the expense of the lender. It is suggested that a neutral body examines the chances of success and if encouraging, give a specified time period for the reconstruction without compromising the collateral of the lender. However, this should not be the mechanism for resolving disputes.
 118. Similarly, legal provisions and procedures, labour laws and social stigma are the major factors hampering the closure of enterprises which are heading for ultimate collapse at much cost to all concerned. Thus, the legal provisions and procedures must be simplified for closures. Labour laws too should be amended to make it easier for such

eventualities. Compensation formula should also be specified by law to make things easier and transparent for both parties.

119. Obtaining the services of Credit Information Bureau (CRIB) is an additional recommendation for improving lending to SMEs. Lending institutes are required to provide list of loan defaulters to the Credit Information Bureau (CRIB) by regulation. Once a businessperson fails he/she will be blacklisted according to this requirement. Although this is good from the lenders' point of view, Task Force has the impression that any businessperson can have good and bad times and therefore there should be an in-built system to delete names from the CRIB after a certain number of years persons with good records.

Recommendation 5

- 1. Encourage active participation of Venture Capital Companies and Leasing Companies to provide credit support for SMEs**
- 2. Implement low cost credit negotiation and project monitoring activities initiated by the IDB**
- 3. Explore the possibility of introducing an effective Credit Guarantee Scheme and Equity Investment Scheme for SMEs**
- 4. Facilitate SMEs operating in industrial estates to use their land as a bankable asset.**
- 5. Disburse loan and allied facilities with the assistance of BD providers.**
- 6. Amend the Loan Recoveries Act and provide opportunities for sick industries to reconstruct**
- 7. Install good financial discipline in SMEs**

4.2 Access to appropriate technology

120. Technological under-development is widely recognized as a key determinant of narrow and vulnerable industrial base of many developing countries. This is of particular relevance to SMEs as they are at the lowest end of technological learning process compared with their counterparts in the large-scale sector. Similar to many of the developing countries, SMEs in Sri Lanka, use a wide spectrum of technology ranging from traditional to state-of-the-art. At firm level, there is hardly any in-house research and development (R&D) efforts or joint research with domestic research institutes. The majority of SMEs are ignorant of the need to improve and upgrade the quality of their product on a regular basis. They seem to be content with to continue production according to traditional, time-honoured techniques and methods instead of adopting new, technologically more advanced methods. This is because, SMEs are largely family-based enterprises and have limited access to information

and technology. Hence, the majority of them do not recognise the need for modern technology as vital for growth and expansion of their business activities. Among those who realise the need for adopting new technology, the majority face significant problems in accessing technology. Moreover, technology adopted by many small-scale enterprises are not appropriate. Inappropriateness occurs through long delays in recouping the investment in new technologies, high initial investment required to acquire the technology and lack of suitable technology related to the specific needs.

121. The medium scale enterprises however, are generally more dynamic and are able to upgrade their machinery when needed subject to financial constraints. It is also important to note that there has been a process of modernization of machinery and equipment used by some of the SMIs over the past two decades. Yet, the broad scenario that emerges is that the large majority of SMIs especially small producers are virtually cut off from the benefits of modern or upgraded traditional technologies. The SMEs have limited access to information on product and process technology. The selection of equipment and technology is mostly based upon their limited exposure, experience and information from suppliers and relatives. Required advice for technology upgrading is often not widely available. This has made their choices of equipment and technology, and their chances of upgrading for greater efficiency very limited. On the other hand, the outreach by Industrial Extension Officers from IDB and other government agencies is limited due to resource constraints. Domestic research and development (R&D) institutions including universities maintain little or no interaction with SME sector enterprises.
122. Quality control is yet another important aspect relating to low level of technological sophistication. Improvement in product quality is vital for growth and expansion of SMIs as it would enable them to penetrate into more sophisticated market segments both in local and foreign markets. As revealed by some of the survey evidence, almost 91 per cent of sample industrialists selected from Matara, Kurunegala and Kalutara districts did not receive any training in quality control methods and only about 20 per cent of the industrialists had their own laboratory facilities¹⁶.
123. Based on existing evidence, the problem of low technology in SME sector enterprises could be attributed to four major reasons: a) no convenience access to better technologies, b) inefficiencies in the diffusion of technologies among entrepreneurs by state technical support agencies¹⁷,

¹⁶ Advisory Council for Industry, 1996. Improving Quality Management in Small and Micro Industries.

¹⁷ A detailed and systematic analysis on technological capabilities of Sri Lanka can be found in " Trade Liberalization in Sri Lanka ; Exports, Technology and Industrial Policy," by G. Wignaraja (1998).

c) high financial costs involved in effective adoption of new technology, d) lack of human resources at enterprise level, and e) lack of motivation amongst producers in actively seeking out new technologies or to improve the marketability of their products in competitive markets. The net effect of these factors is lack of innovativeness and hence low competitiveness in product markets. During the public hearings held outside Colombo, it was evident that the majority of SMEs have no access to better technologies relating to product and process systems and quality control methods. State agencies entrusted with the task of serving private businesses with technology and quality control had little interaction with industry and maintained a non-commercial approach to technological research. The lack of funds to purchase imported machinery and equipment have further discouraged continual upgrading of product and process technologies, increased attention to research and development and cost reduction.

124. Access to and the application of appropriate technology, however, are crucial if the SMEs are to move towards higher value added production and improve their competitiveness and export opportunities. The East Asian countries used selective industrial policies to rapidly promote indigenous technological and other capabilities. For example, Singapore used highly selective policies towards foreign direct investment to promote particular activities and induce the upgrading of technologies and skills¹⁸. All these policies involved integrated and targeted interventions in both product and factor markets, the building of support institutions and close involvement of the enterprise sector. In Hong Kong, funding for technological innovation has been taken up strongly by the government. For example, in 1999, ‘Small Enterprise Research Assistance Scheme’ was established under a major ‘Innovation and Technology Fund’ of HK \$ 5 billion¹⁹.
125. In line with the above, the strategies for strengthening technological capabilities of SMEs in Sri Lanka need to be developed paying particular attention to the following: a) expansion of technical service network at the district level, b) establish a “Technology Development Fund”, c) provide funding facilities, and d) create a market for local research and development. The first, expansion of technical service network at the district level, is vital in view of the severity of low level of technology at enterprise level and limited outreach by state agencies engaged in promoting R&D activities. The technical services required at district level includes quality control, common facilities for instrumentation, testing and calibration. This requires capacity building of R&D institutions such

¹⁸ Singapore Productivity and Standard Board, 2000. SME 21: Promoting SMEs for the 21st Century.

¹⁹ Industry Department (Hong Kong SAR Government), 1999. Small and Medium Enterprise Development Support Plan.

as the Industrial Technology Institute (ITI), Institute of Fundamental Studies (IFS), Sri Lanka Standards Institute (SLSI) and National Engineering, Research and Development Centre (NERD) and the industrial “extension” organizations such as Industrial Development Board (IDB), Natural Resources, Energy and Science Authority (NRESA). These institutions need to be more demand oriented and extend the delivery network to assist enterprises at the district level. In fact, some of them need to become facilitators rather than continuing as direct service providers. In addition, private sector associations and Chambers of Commerce and Industry should also be encouraged to actively participate in providing these common facilities as the efforts made by the state have often failed in the past.

126. The second, establishing a “Technology Development Fund”, is a strategy successfully adopted by some of the high growth economies in East Asia²⁰. The purpose is to provide assistance in the development of new products and technologies and supporting the individual or joint R&D efforts of SMEs. Initial funding for this purpose should be met by the state in view of potential welfare benefits to the national economy. The NGOs and donor agencies should also be encouraged to intensify their efforts to build up such a fund in addition to transfer technologies. The fund should be managed jointly through a public–private partnership. A voucher scheme should also be introduced for effective implementation of the proposed R&D project.
127. The third, supply of funding facilities for technology upgrading, is also widely practiced in many developing countries as SMEs are not in a position to undertake R&D activities due to weaker financial position. The fourth strategy, creating a market for local R&D, is particularly important in the present context of pro-market policy reforms. It broadly involves recognition of SME friendly innovations, establishing links between state run R&D institutions and SMEs and educating SMEs on property rights of innovations. It also involves encouraging universities and other technical institutions to participate in SME development by providing access to information and appropriate technology. Introduction of an annual award scheme for the “ Best Innovative Firm” and “Best SME Friendly Innovations” would also contribute towards creating a market for local R&D.

²⁰ For example, the Innovation Development Scheme (IDS) in Singapore provides assistance through grants up to 50% of qualifying costs which must involve the innovation or significant improvement of products, processes, applications or services. It must also yield notable improvements, e.g., reduced cycle time, high product/service quality, and higher productivity.

Recommendation 6

- 1. Establish technical service centres at the district level with the assistance of existing body of institutions engaged in providing R&D services.**
- 2. Establish a ‘Technology Development Fund’ for SMEs.**
- 3. Provide financial assistance for SMEs to update /acquire new technology.**
- 4. Create a market for local R&D.**

4.3 Access to information and markets

128. Linked with technology upgrading and quality control is the issue of availability of timely information and services that enhance the market access to SMEs. Information is expensive and not widely available and yet it is the most powerful competitive edge for business success. More specifically, this refers to information and support services required for selecting target markets, product development, and packaging, distribution and sales promotion. This is yet another obstacle affecting the growth and expansion of SMEs in developing countries. In the context of Sri Lanka, this is of special significance in view of its commitment towards pro-market and liberalized economic policies. In addition to domestic competition from large-scale enterprises, presence of competition pressure from foreign sources clearly demonstrates the need for an efficient, timely and affordable information system for SME development.
129. Small firms virtually have no sources of information on other markets or opportunities outside their immediate surroundings. The lack of knowledge and limited access to information on market opportunities have caused small-sector enterprises to depend on judgement and speculation. In a competitive business environment, this is very costly and limits their ability to expand the market. Existing arrangements to supply such information to SMEs are grossly inadequate and the lack of access to modern information technology (IT) has further aggravated the situation.
130. Most SMEs service regional or local markets. Their market information is often limited to their specific market segments. Quite often, information relating to developments in market demand and innovation is received through word of mouth. Moreover, the information requirements of SMEs depend on the size of the enterprise, stage of growth and type of business. The diversity in needs and the sheer number of SMEs makes it

difficult for any government organization to fulfill the information requirements of SME sector enterprises in the national economy.

131. In addition to lack of information, the absence of marketing skills at enterprise level has led to SMEs being more production oriented rather than becoming more market oriented. Many of the SMEs especially small-scale enterprises lack skills on product design, packaging and sales promotion which are vital for being attractive and competitive in the market. The typical selling method of SMEs especially small-scale enterprises is to operate through their own outlets. Many of them are also not in a position to promote their products and services through advertising and sales promotion mainly due to lack of skills and high costs. In fact, the absence of marketing skills has resulted in the early demise of business enterprises.
132. During the public hearings it was evident that SMEs do not receive enough information relating to foreign markets. Some of the SMEs operating outside Colombo were of the view that they are in a position to come up with products with good export potential subject to availability of sufficient advice and guidance on export markets. For example, at Matara, some of the entrepreneurs who have already developed some innovative products based on coir, goat milk and traditional cereals identified lack of information and guidance as a major constraint in reaching foreign markets. Lack of e-business facilities and exposure to foreign markets were also cited as factors constraining their access to foreign markets.
133. With respect to information and market access, it is important to cite some evidence from Asia. In Taiwan, the China External Trade Development Council (CETRA)²¹ offers a wide range of support services²² for SME sector enterprises. For example, CETRA'S website, Cetrinet (<http://www.cetra.org.tw>) provides detailed information on foreign markets. The Design Venture Programme (DVP) administered by the Design Centre²³ in Singapore, encourages local companies to improve product design. The DVP covers part of the enterprise's approved design product costs such as design research, consultancy fee, data collection and analysis, and the production of three-dimensional mock-ups. The Trade Development Council (TDC) in Hong Kong assists SMEs in obtaining world-wide trade and industry information. It also runs a "Virtual SME Center" on the TDC website to broadcast up-to date business information to SMEs 24 hours a day. With respect to services that enhance the market

²¹ The foremost non-profit trade promotion organization in Taiwan.

²² This broadly includes market development, information services, exhibitions, market research and consulting services, design promotion, convention services and trade education.

²³ A division of the Trade Development Board in Singapore.

access, the TDC provides three main services: a) the design gallery²⁴, b) local trade fairs²⁵, and c) Trade enquiries service²⁶.

134. Considering SME's comparative disadvantage in access to market information and existing information technology facilities in Sri Lanka, creation of an SME website was considered as timely and appropriate for SME development. The purpose is to provide e-business facilities for SMEs through an e-commerce portal at district level. The potential benefits of such a system would include dissemination of trade information into remote areas, reducing the costs of doing business, and improving linkages with the global economy. In view of these broad objectives, it is important that the proposed SME website provides extensive coverage of information relating to both domestic and foreign markets.
135. The information requirements of the SMEs could also be met by initiating a Business Report on an annual basis. In addition to providing general information on SMEs and the macro economic trends, such a report should feature industry overviews, company profiles, interviews, trade show reports, as well as information on manufacturers and exporters²⁷. It needs to be published in Sinhala, Tamil and English. The successful implementation of this recommendation requires active support from the Department of Census and Statistics, Central Bank of Sri Lanka, EDB and Chambers of Commerce and Industry.
136. As a strategy to promote SME products within the domestic market, various other trade promotion activities have also been considered as appropriate for SME development. This broadly includes providing opportunities for SMEs to participate in trade promotion exhibitions in local and foreign markets, identification of export oriented projects, and introduction of low cost advertising and sales promotion. Considering the budgetary constraints and the national level and pro-private sector orientation of development activities, it is recommended that these activities be carried out jointly by government, non-government, private sector and donor organizations.

²⁴ This is a retail outlet for SMEs to source buyers, test the market with new products and innovative designs, and build brand awareness among an international clientele.

²⁵ These trade fairs provide ideal venues for SMEs to market their products and contact overseas buyers. TDC's 'Economy Booth' participation package provides smaller booth option for SMEs at an affordable price.

²⁶ This is a free of charge computerized trade-matching service for local companies connected with TDC's global network of 50 offices in 34 countries.

²⁷ For example, in Taiwan, CETRA publishes a full-colour magazine called "Taiwan Products Magazine".

Recommendation 7

- 1. Create a SME website.**
- 2. Provide opportunities for SMEs to participate in trade promotion exhibitions.**
- 3. Provide access to foreign markets through e-commerce facilities.**
- 4. Identification of export oriented projects for SMEs.**
- 5. Initiate a business report on SMEs on an annual basis.**

4.4 Business development services

137. Business Development Services (BDS) have been recognized as an important element in promoting SMEs. The term 'BDS' broadly refers to any non-financial support service provided by any organization to strengthen market competitiveness of SMEs. This includes supply of information, training, research and consultancy services relating to key functional areas of a business enterprise. It also includes advisory services on tax regulations, legal advice and preparation of project proposals. The BDS in Sri Lanka at present, is being provided by a wide range of suppliers representing government, non-government, private sector organizations and the donor community²⁸. In addition to these providers, there are also a substantial number of small-scale providers who offer BDS on commercial basis.

138. The BDS system in Sri Lanka is supply driven and found mostly in urban centres of the Western Province. Only a few BDS deliver effective and valued services for SMEs. As a result, the outreach is limited and the most frequent type of services provided by them includes information, training programs and marketing. The public sector BDS providers are ineffective and mostly Colombo centred while the majority of private sector BDS providers are targeted at larger clients and usually not suitable for SMEs. From the SME's point of view, information on tax laws, commercial laws and regulations are difficult to collect, especially for those operating outside Colombo. These enterprises function with little or no access to information on tax laws and government regulations affecting business sector enterprises. When conflicts arise or when they encounter problems, these enterprises depend on the mercy of

²⁸ Some of the major BDS providers include MEDIPIP (Wasanthaya Programme), Ministry of Tertiary Education (Vocational training), Ministry of Rural Industries (Training), IDB (training and technology services), Sri Lanka Business Development Centre (SLBDC), Chambers of Commerce and Industry, Small & Medium Enterprise Developers Project (SMED), UNIDO (business incubator services), ILO, USAID, GTZ, Sarvodaya etc.

government officials. The situation however, is worse with respect to small-scale enterprises. The limited coverage of BDS by existing service providers implies the need for enhancing the scope for their services and creation of new BDS products. It also requires enhancing the use of IT for low cost information sharing among SMEs at provincial level.

139. In order for BDS to address the needs of SMEs, deliver effective services and provide a wider coverage of entrepreneurs the focus need to be placed on private sector delivery. In view of serious budgetary constraints at the national level, it is very unlikely that the government will be able to increase the delivery of BDS in the immediate future. Moreover, considering the wide diversity of BDS required by the SMEs and their dispersion across different economic and geographic regions, it is commonly accepted that effective delivery of BDS requires the private sector to take the lead in the delivery of BDS.
140. The emphasis should, therefore, be placed on two important aspects: a) the government shifting from direct delivery to playing a facilitating role, and b) market orientation of BDS. The first, government providing a facilitating role broadly includes identifying BDS opportunities for SME development, stimulating demand for BDS, and linking BDS providers and SMEs. The initiatives of the Wasanthaya Programme²⁹ to prepare a directory of BDS providers is a positive step towards this effort. Similarly, the IDB has already redefined its role as a facilitator rather than continuing as a direct service provider. The government could further strengthen its facilitating role between service delivery by the private sector and their clients by providing incentives for larger BDS providers to redesign their products/services focusing on specific BDS requirements of SMEs.
141. The second, becoming more market orientated, involves proper targeting of SMEs, development of high quality services and charging a fee for the services based on cost and demand considerations. This would be a substantial improvement from the current situation of a large number of government-funded programs that are not valued by SMEs. At least during the initial stages, the introduction of a voucher scheme or similar incentive scheme could act as a strategy to popularize use of BDS among SMEs. Creating awareness on BDS among SMEs especially in rural areas, could also be yet another indirect involvement on the part of the government in promoting wider use of BDS.

²⁹ Refers to an enterprise development programme introduced by the MEDIPIP. National Strategy for the SME Sector in Sri Lanka

Recommendation 8

- 1. Maintain a comprehensive and up-to-date data base on BDS providers.**
- 2. Encourage BDS providers to enhance the scope of their services.**
- 3. Introduce a voucher scheme to popularize use of BDS among SMEs .**
- 4. Create awareness on BDS among SMEs.**
- 5. Promote business incubator programmes with joint participation of the public sector, private sector, NGOs and the donor community.**

4.5 Linkage formation: clustering & subcontracting

142. Clusters and subcontracting help SMEs to become more competitive, upgrade technology, transfer skills and access to wider markets. It refers to either farming out small quantities of production or distributing the manufacture of components at different stages of production. Such networks among different industrial units have been to the advantage of all parties concerned. From a policy perspective, clustering offers opportunities for government agencies and NGOs to reach large numbers of SMEs through a single policy initiative. This enhances the cost-effective delivery of services. The experience of Thailand, Malaysia and Republic of Korea clearly demonstrate the co-existence and collaboration between SMEs and large firms via effective networks of sub-contracting. In these countries large enterprises are compensated by the state for marketing of outputs of SMEs and supplying information, technologies, skills development and credit. In fact, Malaysia and Thailand have set up funds for such purposes.
143. As revealed by existing evidence, sub-contracting or use of large trading houses is not yet popular among SMEs in Sri Lanka. In spite of early efforts by the government³⁰, sub-contracting activities still are ad-hoc and limited to few areas such as manufacture of artificial flowers, joss sticks, garments, gems and jewellery, electrical components, umbrellas, food and leather products. By and large, existing sub-contracting practices are limited to arm's length relationships that rarely make a significant transfer of information, skills and technology. This implies the need for sensible policy interventions on the part of the government and active support from the private sector and the donor community to promote sub-contracting practices in industry.

³⁰ For example, the government established The Sub-Contracting Exchange in 1980. National Strategy for the SME Sector in Sri Lanka

144. Recent efforts by the government, private sector organizations and the donor community to promote sub-contracting practices among SMEs are in the correct direction and need to be continued with necessary policy support. The application of industry cluster approach was initiated by the Competitiveness Initiative Project of the USAID focusing on 8 industry clusters: a) ICT, b) rubber, c) tea, d) tourism, e) ceramics, f) coir, g) jewellery, h) spices and allied products. Subsequently, the MEDIPIP, adopted the sector strategy of promoting industry clusters relating to 18 sub-sectors³¹ in manufacturing. These efforts need to be continued with proper targeting and policy support.
145. The response from the private sector in this regard is even more promising. The setting up of the Subcontracting and Partnership Exchange (SPX) is a major step towards promoting SMEs through sub-contracting. Similarly, its establishment of links with the private sector through the SMED made for access to the international network of 60 SPXs established in 30 countries world wide. These efforts need to be continued with proper targeting and policy support.

Recommendation 9

- 1. Promote sub-contracting with proper targeting for improving the technological capabilities of SMEs.**
- 2. Establish business links between SMEs and large-scale buyers in Sri Lanka and abroad.**
- 3. Form industry clusters on sub-sector basis.**

4.6 Infrastructure

146. Lack of adequate infrastructure, particularly in the fields of power, water, telecommunications and road access affects production, its cost, delivery and finally market competitiveness of any enterprise irrespective of its size. The SMEs especially, find it difficult to compete with existing firms when they do not even have access to essential common facilities that are required for a business to run efficiently. The severity of this issue needs to be analysed in terms of availability, quality, reliability and cost of supply. Similar to many other developing countries the situation is worse for SMEs located in the provinces. For example, in many Districts outside Colombo, still lack electricity and pipe borne water. This hinders the

³¹ This includes rubber, ceramics, coir, ICT, leather, leather products & shoes, apparel, handlooms & textiles, food and food processing, gem & jewellery, tea, spices, plastics, wood products, metal fabrications and the packaging sector.

development of certain types of potentially prosperous industries, like brassware, silverware, furniture, coir products etc. It also prevents industries from using simple power tools, which can improve the quality of the finished product and raise productivity and value added. As revealed during the public hearings, access to 3-phase electricity is still a problem in Kandy and Trincomalee Districts.

147. With respect to electricity, the most pressing issue is the irregular power supply. Frequent disruption in power supply adversely affects productivity, particularly in precision and high technology outputs. Constant voltage fluctuations make the situation worse causing serious damages to machinery and equipment including computers. The high cost of electricity is the other crucial factor that seriously affects the cost structures of SMEs. In this regard, the large-scale enterprises however, have the option of purchasing their own generators while many of the SMEs have to bear the high tariff charges. As pointed out by many analysts, the electricity supply industry in Sri Lanka is facing a dual crisis of capacity and financial management and the government has already recognized the urgency of power sector reforms.
148. Road access, phone connections to factories, lack of water supply, access to land and buildings and absence of waste disposal systems have been identified as major infrastructure problems faced by the SMEs³². As reported by SME owners, the road transport system outside Colombo is poorly maintained and unclean. In some areas there are no access roads to markets and enterprises located in remote areas of the districts outside Colombo have transportation problems in procuring raw materials and inputs. Similarly, pipe-borne water is a crucial problem for many SMEs located in dry zone areas. Moreover, the absence of proper waste disposal systems have also caused problems for SMEs. The added cost in this regard in terms of transporting waste material to a suitable dumping site especially when they cannot find places to dispose such material is significant and requires some solutions. Obviously, solutions to infrastructure problems need to be worked out at the national level and the government has already identified power, road transport, telecommunication, and land as priority sectors for policy reforms. For example, the Budget 2003 presents sector specific proposals for land, roads and power and energy sectors.
149. The introduction of industrial estates (IE) as a strategy to provide infrastructure facilities for industrial development is yet another important aspect worth considering. The IE program in Sri Lanka has a long history and at present, it is being implemented by seven different public sector

³² Evidence given at the public hearings and findings by Project SMED (1999) and IPS Industrialization Series No. 7 (1999).

institutions³³ according to their own objectives, rules and regulations, finance and other resource constraints. The end result has been the creation of IEs without proper infrastructure facilities and hence high rate of under utilization. As reported by the industrialists, the IEs suffer from inadequate supply of water, electricity, roadways, drainage systems and pollution control systems. Recent initiatives by the Ministry of Industrial Development to promote regional industry development through Industrial Parks (IP) are also associated with poor infrastructure facilities. In spite of these drawbacks however, the current drive to establish IEs and IPs on a zonal basis is a positive step towards improving infrastructure facilities for SMEs located outside the Western Province. The proposed Regional Economic Development Commissions covering five regions under the revised BOI Act (2002) is also expected to develop and manage industrial sites, zones, parks, estates and other premises and other infrastructure needs for industries³⁴. At the public hearings, many of the entrepreneurs came up with the suggestion of facilitating access to unutilized government buildings for SMEs as an immediate solution to the problem.

Recommendation 10

- 1. Create industrial parks for SMEs in rural areas.**
- 2. Improve facilities of existing industrial estates and industrial parks.**

4.7 Enabling legal and regulatory framework

150. In spite of various policy reforms introduced by successive governments during the post liberalization period, the degree of bureaucracy inherent in business-government interaction is reported to be very high in Sri Lanka. This is due to both direct and indirect state interventions in economic activities through legislative and administrative regulation. It is widely accepted that outdated regulations and rigid administrative procedures imposed by public sector institutions raise costs and discourage dynamism in trade and industry. On a comparative basis, the high performance of Singapore, Hong Kong, Dubai and Mauritius have been partly attributed to less regulatory orientation of such economies.

³³ MEDIPIP, MI, BOI, IDB, Industrial Services Bureau, Urban Development Authority and Mahawali Development Authority.

³⁴ The Western Region, The Southern Region, the North East Region, the Central Region and the North Western Region.

151. The influence of legal and regulatory impediments on business development was examined in detail by a Committee on Deregulation (2001) and its findings and recommendations were given in a paper titled ‘An Action Program for Deregulation’ (February, 2002). It broadly covers the rules and regulations affecting the entire business sector including the SMEs. Accordingly, the government has already taken action to review and amend the following laws affecting the macro-economic environment; a) Inland Revenue Law, b) Revenue Authority Law, c) Fiscal Responsibility Law, d) De-Regulation Laws, e) Economic Management Laws, f) Intellectual Property Laws and g) BOI Law, h) Termination of Employment of Workmen’s Act, i) Industrial Disputes Act, j) Workers Compensation Ordinance, etc.³⁵ From the point of view of SME development however, legal and regulatory reforms need to be carried out with due considerations placed on the problems faced by the SMEs. The following are some of the vital legal and regulatory issues which deserve the immediate attention of policy makers and others engaged in deregulation: a) enactment of the New Companies Act, b) corporate tax regulations, c) labour laws³⁶, d) laws and regulations relating to utilization of state land, e) government tender procedures, f) anti-dumping legislation, and g) duty anomalies.
152. The main concern with regard to the Companies Act is simplification of procedures enabling SMEs to enter, exit and change their businesses in response to market signals. Even though some of these issues will be addressed by the proposed amendments to the Companies Act, it is still limited to only incorporated businesses. The revisions need to be extended to cover proprietorships and partnerships. Similarly, in the areas of labour and income tax, the SMEs deserve some concessions during the initial three years of business operations. This was an issue repeatedly pointed out at the public hearings and it was justified on the basis of fragile macro-economic conditions of the national economy. In view of poor record keeping practices and lack of accounting skills at SME level, it has been recommended to introduce a simplified tax system and to allow Registered Auditors to certify the accounts of SMEs. It has also been suggested to introduce low tax rates for SMEs operating at Provincial level. The issues relating to the land market is widely discussed by the Deregulation Committee and the government has already taken action to introduce remedial measures. However, there is a need for facilitating the use of State land for SMEs in the Provinces.
153. During the public hearings, the need for deregulation was pointed out with respect to high value added sub-sectors such as mineral processing. In the case of the Construction Industry however, the absence of a national policy and a regulatory mechanism to promote business activities

³⁵ The Future: Regaining Sri Lanka and Budget Speech 2003.

³⁶ This will be covered under the sub-section on Labour and Industrial Relations.

of the Construction Industry was emphasized. In the area of environmental protection, except the National Environmental Act, the presence of several other laws and regulations relating to environmental protection³⁷ has also been identified as a regulatory constraint on SMEs. This needs to be addressed by introducing necessary amendments to the National Environmental Act.

154. Public procurement procedures could provide some incentives to SMEs. This could be done at all level of government by reserving and implementing a percentage of contracts for SMEs and it is a common policy followed by many of the Asian countries as well as developed countries such as the United States. Similarly, the existing Tender Procedures and Guidelines issued by the Government of Sri Lanka also provide some incentives for local value-added industries as against suppliers of imported products³⁸. In practical terms however, the SMEs are not benefited by these regulatory provisions due to various administrative and bureaucratic practices at the implementation stage. For example, some of the conditions stipulated by Tender Boards (e.g., immediate supply of large quantities, at least 10 years of business track-record, etc.) are highly restrictive for SMEs. This is highly discriminatory against SMEs and favourable to suppliers only from foreign sources. In view of these considerations, it has been recommended to request government sector institutions that in following established tender procedures to provide maximum benefits to SMEs.
155. As noted earlier (Section 2.3), unfair competition from low priced sub-standard products present a serious threat to SMEs. In order to arrest this trend, there is a strong need for effective implementation of Anti-Dumping Laws. In addition, some institutional support is also needed to obtain WTO concessions for SME development. Along the same lines, some remedial measures need to be introduced with respect to duty anomalies relating to import of raw-materials and spare parts.

Recommendation 11

- 1. Amend the Companies Act with a view to facilitate SME development.**
- 2. Introduce a simplified tax system for the SMEs.**
- 3. Release SMEs from labour and tax obligations for the first three years of business operations.**
- 4. Facilitate use of state land for SMEs located in the Provinces.**
- 5. Promote deregulation in high value added sub-sectors.**
- 6. Develop a national policy for the Construction Industry.**

³⁷ Public Nuisance Act, the Local Bodies Act, etc.

³⁸ Refers to exemption of BIT and customs duty on raw materials or inputs in calculating total value of the tender and 20 per cent preference for value added industries.

- 7. Request government organizations that in following established administrative procedures to provide maximum benefits to SMEs.**
- 8. Effective implementation of Anti-Dumping Laws.**
- 9. Obtain WTO concessions for SME development.**
- 10. Take remedial measures to avoid duty anomalies.**

4.8 Industrial relations and the labour environment

156. As mentioned in Section 2.3, a range of regulatory and institutional structures complicate the relationships between employer and employees. As viewed by the National Employment Policy Statement, the weak tripartite partnership between the government, employers and trade unions has been a deterrent to Sri Lanka's economic growth and social progress in the past. The rigidities of our labour relations framework and the adversarial approach of our industrial relations system have generally been looked upon as negative factors in our labour market. In fact, investors and the business community have repeatedly expressed their concerns over rigidities and inappropriateness of laws governing manpower issues in Sri Lanka.
157. The problems relating to industrial relations and the labour environment in Sri Lanka are two fold: a) absence of a simple and flexible labour regulatory system and appropriate institutional structures, and b) absence of an education and training system to provide appropriately trained workers. The SMEs are severely affected by these constraints due to lack of knowledge, experience and other resources to deal with rigid labour regulations.
158. The remedial measures however, require a number of reforms at national level. In fact, the government has already identified labour and education as priority areas for policy reforms. Already, the government has begun to address issues relating to labour regulations and develop a national employment policy for Sri Lanka. In the area of education too, the government has initiated the reform process, including introducing greater flexibility at tertiary level and private sector participation in technical and vocational training. The following are some of the major strategic initiatives that have been recommended by the National Employment Policy Statement under labour reforms:
- Develop partnership at national level through conducive tripartite social dialogue to jointly deal with difficult manpower and industrial relations issues

- Implement the proposed amendments to the Industrial Disputes Act and Termination of Employment Act with a safety net
- Labour Management Cooperation through dialogue at all levels for stable and healthy Industrial Relations
- Continuous development of the Human Capital Industry
- Training systems restructured to meet future demands.

Recommendation 12

Implementation of proposed policy reforms for labour with joint participation of all stakeholders which includes employers, employees, trade unions, NGOs, donor community and the government.

4.9 Entrepreneurship skills, retraining and management

159. The acquisition of relevant vocational training, technical skills and business skills is generally regarded as one of the critical factors for success in SMEs. Management and entrepreneurial skills are crucial for enterprises to become dynamic and growth orientated. Most of the SME owners have not been trained in business management and lack a proper book keeping system to facilitate vital financial decisions. As a result, they face many management problems including under-estimation of required funding, use of out-dated technology, over-estimating of target markets and marketing capabilities.
160. Lack of skilled workers is yet another problem affecting the performance of SMEs. In spite of various training programmes offered by the existing body of institutions representing public, private and non-government sector organizations, the quality of training is inadequate and does not meet skill requirements of the SMEs. Many trainers are not qualified in the relevant discipline and lack experience. Both the vocational and technical training system are under-equipped and under-funded. The entire training system is inflexible and less responsive to industrial and technological requirements of the business sector. The following are some of the strategic initiatives recommended by the National Employment Policy Statement to promote tertiary and vocational training in Sri Lanka. The government has already incorporated some of these recommendations into the 2003 Budget Proposal. e.g., establishment of a

Human Resource Development Fund and financial incentives for Corporates.

- Define the role of the government as a facilitator, standard setter and regulator in vocational training
- Continuous development of the Human Capital Industry
- Formation of a National Human Capital
- Training systems restructured to meet future demands
- Facilitating Government-Industry relationships
- Financial incentives to Corporates
- Financial assistance to disadvantaged groups.

161. In order to meet industry specific skill requirements of the SMEs it has also been recommended to conduct skill development programmes tailor made to specific industry sub-sectors. Programmes on productivity enhancement were also considered as equally important in promoting competitive strengths of SMEs. It is important to note however, that the delivery skill development programmes should be primarily done by the private sector with the government playing a facilitating role.

162. It is widely known that the education system in Sri Lanka has not been able to provide the country with the work force ready to face the challenges of a dynamic market oriented economy. The university system and the other tertiary education institutions have failed to deliver appropriately skilled labour needed by the economy and specifically by SMEs. These limitations of the education system require a number of reforms before appropriately trained labour can be produced. These measures will benefit the entire economy including SMEs. Responsibility for education, entrepreneurship, skills and management however, rests with a wide range of institutions. From the SMEs point of view, on going policy reforms on education need to consider the following as priority areas:

- The inclusion of entrepreneurial skills in the existing curriculum of schools.
- Tertiary courses and professional training to include entrepreneurial and management skill training.
- Government to coordinate and tender out to the private sector training for technical and vocational education.
- Government to train public sector officials servants dealing with SMEs to provide a more efficient service.

Recommendation 13

- 1. Conduct skill development programmes with sub-sector focus.**
- 2. Implement proposed policy reforms for tertiary education recommended in the National Employment Policy Statement.**
- 3. Encourage Universities and other tertiary education institutions to provide training support for SMEs. It should include as priorities: a) the inclusion of entrepreneurial skills in the existing curriculum of schools, b) tertiary courses and professional training to include entrepreneurial and management skill training.**
- 4. Government should play a facilitative role and encourage more private sector participation providing skills development programmes.**
- 5. Introduce a voucher system as a strategy for effective utilization of funds set apart for skills development.**

4.10 Cleaner Production and Environmental issues

163. Cleaner production is an important issue for small businesses and their workers. It can improve their immediate environment, competitiveness and access to markets. CP is a perspective and a decision making process that takes into account, simultaneously, both economic and environmental progress and sustainability. It is measured as a condition in which the impact of pollutants produced and the natural resources consumed for each unit of product or service are reduced such that growth and development are economically, environmentally and socially sustainable. The principles of CP originated in manufacturing, but they are equally applicable to activities in transportation, mining, health services, agriculture, forestry, tourism and many other sectors.
164. Under various names, many of the concepts essential to the achievement of environmental protection have been pursued in Sri Lanka for more than a decade. Pollution prevention, waste minimisation, clean technology, environmental management, materials productivity, global competitiveness, natural resource conservation and more, are all aspects of cleaner production. Each is promoted for a different reason and through different institutions and mechanisms.
165. The Ministry of Environment and Natural Resources (MENR) and Central Environment Authority (CEA) are the focal institutions directly involved in environmental protection, regulation and enforcement. The MENR functions as a policy making body for environmental policies and
-
- National Strategy for the SME Sector in Sri Lanka

action plans for environmental protection at the national level while the CEA, functions as the main regulatory and law enforcement authority. The CEA is empowered to delegate some of its duties and functions to other government agencies especially operating at Provincial (Provincial Councils) and District level (District Environment Agency, DEA). In addition, various line ministries³⁹, local government institutions and semi-government organizations⁴⁰ are also empowered with certain activities relating to environmental protection and management. As pointed out at public hearings, the presence of multiple institutions to enforce environmental regulations and lack of co-ordination among them have caused serious problems to SMEs especially at district level. The highly regulatory character and less development orientation of these institutions have also caused various administrative and procedural problems for SMEs. The capacity limitations of public sector institutions (technical skills, laboratory facilities etc.) and the absence of BDS providers in the area of waste management and clean technology have further worsened the situation.

166. The role of environmental authorities and related regulations is to facilitate development while ensuring compliance with safeguards to minimize environmental degradation. CP measures offer an opportunity for environmental authorities to achieve environmental compliance through incentive-based strategies rather than through the conventional command-and-control approach. Studies reveal that the command-and-control approaches adopted by the environmental authorities tend to unduly obstruct enterprise development. There is significant potential to combine the dual objectives of economic development and environmental protection by promoting 'green economic activities' such as eco-tourism and geo-tourism. Such enterprises must be encouraged through incentives, which reflect their indirect environmental and social benefits.

167. The MEDIPIP has already initiated certain activities as a part of its recent efforts to integrate CP practices to industrial development. The establishment of the National Cleaner Production Centre (NCPC) at SMED of the Federation of Chambers of Commerce and Industry (FCCISL) with donor funding is a major achievement in this regard. The primary function of the NCPC is to provide coordinating and catalytic role for cleaner production by creating awareness and providing training and consultancy services to SMEs on cleaner production. The MEDIPIP is the implementing agency of the NCPC while the SMED functions as the executing agency. At present, the co-ordinating activities of the NCPC are being carried out by the Industrial Policy Unit of the MEDIPIP. As a part of CP promotion activities, the MEDIPIP is also engaged in developing national capacities in setting up Environmental Management

³⁹ MEDIPIP, MLD, Ministry of Irrigation etc.

⁴⁰ National Aquatic Resources Authority etc.

Systems (EMS) according to ISO 14000 international standard. This is being sponsored by the UNIDO.

168. In addition to the SMED, the involvement of financial intermediaries (FIs) in promoting cleaner technologies and pollution control systems among SMEs is yet another important achievement. This could be attributed to two main reasons: a) environmental regulations imposed by regulatory agencies,⁴¹ and b) introduction of pollution control and abatement funds. The former is mandatory for all SMEs operating both in high-polluting and low-polluting sub-sectors. In fact, EPL has become one of the key documents insisted by the FIs in lending money to entrepreneurs. The latter, pollution control and abatement funds, refer to two major industrial credit fund programs: a) Pollution Control and Abatement Fund (PACF),⁴² and b) e-friends fund⁴³. The National Development Bank (NDB) functions as the apex body in the implementation of these two programs and the other participating institutions include Hatton National Bank (HNB), Commercial Bank of Ceylon (CBC), DFCC Bank, Sampath Bank and Seylan Bank. It should be noted however, that the participation of SMEs in these funding schemes has not been up to expectations. This could be attributed to absence of BDS, lack of awareness on CP and associated benefits and less attractive financial incentives.

Recommendation 14

- 1. Enhance the capability of government and private BDSs to assist SMEs in cleaner production and environmental management.**
- 2. Facilitate environmental impact assessment (EIA) requirements of SMEs by providing technical advice and testing services especially at regional level.**
- 3. Develop alternative guarantee schemes for those SMEs interested in investing low cost abatement technologies.**
- 4. Launch an awareness programme on CP targeted at SMEs focusing on cost savings and efficiency benefits of CP.**
- 5. Encourage environment related business activities such as eco-tourism and geo-tourism.**

⁴¹ For example, Environmental Protection Licence (EPL) is compulsory for all enterprises operating in sub-sectors which come under "prescribed activities" of Gazette Extraordinary No. 1159/22 of November 22, 2000.

⁴² PACF is a special financial assistance programme introduced in April 1995 and designed to assist SMEs in environmental protection and management. It's a World Bank Project and funds have been provided by KfW-Germany with an initial grant of DM 7.5 million.

⁴³ The e-friends scheme is a technical assistance and low-cost loan programme targeted at firms interested in waste minimization, resource recovery and pollution control. It was introduced in 199 with 2.7 billion Yen provided by the OECF of Japan.

PART FIVE

Institutional Support

169. This section of the report deals with the institutional support system required for effective implementation of national SMEs strategy. In strategic terms, the aim is to facilitate an enabling institutional environment which will provide the required institutional support to create an internationally competitive SME sector taking the lead in generating employment opportunities, avenues for productivity growth, introducing new technology, modern management practices and access to both domestic and foreign markets. This requires a package of business development services delivered through an integrated institutional network functioning both at national and regional level.
170. The institutional support system pertaining to SMEs in Sri Lanka comprise of four major types of institutions: a) public sector, b) private sector, c) non-government sector (NGOs) and, d) Multilateral and Bilateral organizations. The public sector institutions include all levels of government representing Ministries, Government Departments, Statutory Bodies and Provincial Councils. This involves a large number of public sector institutions offering a broad spectrum of activities from policy and strategy formulation to delivery of support services such as skills development, transfer of appropriate technology, quality assurance services, credit support and access to markets. These institutions are supply-oriented and constrained by various capacity limitations. The private sector institutions engaged in SME development consist of chambers and trade associations, financial institutions, business service providers and private sector firms. By and large, the services of these institutions are limited mainly to the Western Province and hence need to be expanded to other provinces as well.

5.1 Government institutions pertaining to SME development

171. The institutional support services offered by successive governments over the last four decades to promote SMEs fall into two broad categories: a) regulatory function i.e., registration, supervision and control, and b) promotional activities i.e., entrepreneurial development, provision of low cost finance, access to technology, physical infrastructure, input

procurement, product marketing, etc. The former emerged directly from the administrative and regulatory function of the government and the latter as a part of supportive role initiated by the government especially during the post liberalization period. Both functions have been implemented through the use of direct governmental institutions such as ministries, departments and statutory bodies.

172. Under the present administrative setup more than 18 **Ministries**⁴⁴ are directly engaged in SME development work and the services offered by them could be classified into four broad categories: a) policy formulation, b) regulatory functions, c) support services, and d) co-ordination. The first activity, policy formulation, involves overall policy measures initiated by the Ministry of Policy Development and Implementation and sector specific policy measures introduced by other key Ministries such as Finance, Industrial Policy, Commerce and Consumer Affairs, Tourism, Livestock Development, Plantation Industries, Fisheries and Women's Affairs. The second activity, regulation, refers to administrative and procedural functions performed by the Ministries in charge of Finance, Industrial Development, Tourism, Commerce and Consumer Affairs and Employment and Labour. The third category, support services, include research and development, enterprise development, skills development, investment promotion, trade promotion and extension services. The fourth activity, co-ordination, refers to one of the key functions of the Ministry of Policy Development and Implementation created by the new government. More specifically, it involves co-ordination of development programmes initiated by public sector, private sector, non-government sector organizations and the donor community.
173. The second layer of government institutions - **government departments** - engaged in SME development carry out traditional type regulatory activities such as granting approvals, licensing and implementation of various regulatory procedures. Currently, this is limited only to the Department of Textile Industries which provides both regulatory and promotional services for the SMIs operating in the textiles industry. Contrary to traditional type government departments, the National Planning Department (NPD) functions as an inter-face agency between

⁴⁴ Ministry of Enterprise Development, Industrial Policy and Investment Promotion; Ministry of Policy Development and Implementation; Ministry of Finance; Ministry of Tourism; Ministry of Agriculture and Livestock; Ministry of Samurdhi; Ministry of Plantation Industries; Ministry of Fisheries and Ocean Resources; Ministry of Human Resource Development, Education and Cultural Affairs; Ministry of Employment and Labour; Ministry of Commerce and Consumer Affairs; Ministry of Tertiary Education and Training; Ministry of Industry; Ministry of Economic Reform, Science and Technology; Ministry of Youth Affairs and Sports; Ministry of Home Affairs, Provincial Councils and Local Government; Ministry of Women's Affairs; and Ministry of Environment and Natural Resources.

various government institutions and the Ministry of Planning/ Ministry of Policy Development and Implementation particularly in the areas of funding and policy formulation. The NPD is also actively involved in providing donor assisted project support for various institutions engaged in SME development.

174. The third layer of government institutions - **statutory bodies** - involved in SME development account for more than 50 institutions functioning under different ministries. They provide sector specific services (i.e., Textile Training and Service Centre, Coconut Development Authority, National Institute of Plantation Management etc.) as well as common services relating to SME sector enterprises (i.e., ITI, NIBM, EDB, etc). Among them, the IDB, ITI and EDB deserve special mention in view of their involvement with SME development particularly in skills development, technology transfer, and access to markets.
175. The **IDB** is the prime state institution dealing with the promotion of SMIs since 1969. It has the mandate to provide technical and managerial services to SMIs. This includes a wide range of services such as industrial information, carrying out industrial feasibility studies, marketing advice and assistance, technical assistance, engineering services, workshop and foundry facilities, entrepreneurial development and management training and consultancy. The IDB has a network of provincial and district offices and also manages several industrial estates.
176. The **ITI**, former CISIR, is one of the oldest institutions (established in 1955) which has been supporting industrial development of the country by conducting scientific and industrial research and provision of technical services and training. The CISIR was restructured in 1993 and currently functions under the supervision of the Ministry of Science and Technology. Under the present set up, it provides R&D, consultancy, technology transfer, calibration, design and fabrication, trouble shooting and quality assurance services for the promotion of industrial development in the country. The institute simultaneously carries out applied research in the areas of Agro and Food Technology, Chemical & Environmental Technology, Metals Technology, Process and Plant Engineering, Calibration and Measurement and Electro Technology.
177. The **EDB** is the premier state organization dealing with the promotion and development of exports. It functions as a centre for identification and creation of export oriented projects, the enhancement of an export supply base and the provision of specialized services for export, market promotion, product development, and dissemination of trade information. With respect to SME development, the EDB has a separate SME Project Division assigned with the following functions: a) promotion and development of export oriented SMEs in Provinces, b) assisting other

supportive organizations to channel EDB assistance to SMEs and to strengthen the capacities of such focal points, c) improve supply capabilities and skills of SMEs to cater to export markets, d) establishment of an institutional network to assist the SMEs, and e) quality and productivity improvement programmes for export oriented SMEs. Other assistance given to the export oriented SMEs by the EDB include; a) integrated product/market development programmes, b) programme for supply development, product development, product adaptation and quality improvement, c) market promotion and development programmes including trade-fairs, sales missions in overseas, d) facilitation of small producer-exporter link-up for growing and processing etc., e) assistance to resolve problems of export oriented SMEs, and f) conduct awareness, training programmes. In addition to key functions performed at head office level, the EDB has established three Regional offices in Kurunegala, Kandy and Galle to cater to the needs of export oriented SMEs in the North Western, Central and Southern Provinces. The E-commerce centres established at Matara and Hambantota provide a wide range of e-commerce facilities to SMEs.

178. The Sri Lanka Export Credit Insurance Corporation (SLECIC) is yet another semi-government institution which provides assistance to export oriented SMEs. It provides assistance to exporters through various Insurance Policies against non-payment by overseas buyers due to commercial and non-commercial risks. The SLECIC also provides In-house training and Awareness Programmes on Export Credit Insurance and Guarantee facilities.
179. Among public sector financial institutions, the Central Bank of Sri Lanka deals with financial policies while the two commercial banks - Bank of Ceylon and Peoples Bank – provide credit support to entrepreneurs both under SMI scheme and on a commercial basis. These two state banks are in a position to cover a wider cross-section of SMEs through their island-wide branch network as against their counterparts in the private sector. They also conduct entrepreneur development programmes targeted at SME sector enterprises.
180. The Central Environment Authority (CEA) and Sri Lanka Standards Institute (SLSI) interact with the SME sector enterprises as regulatory bodies responsible for environmental regulations and product quality standards respectively. The operations of the CEA, being the sole national authority to administer the provisions of National Environment Act No. 47 of 1980 and subsequent amendments,⁴⁵ are likely to influence

⁴⁵ According to Gazette Extraordinary No. 1159/22 of November 22, 2000 issued under Section 23 of the National Environment Act, Environmental Protection Licence is compulsory for all enterprises operating in industry sub-sectors which come under "Prescribed Activities."

the activities of the entire industrial sector including the SMEs. Similarly, the services of the SLSI, being the key institution to establish national quality standards, are likely to influence the activities of the SME sector enterprises. The quality assurance certificates issued by the SLSI enables SMEs to penetrate both local and foreign markets. It is also responsible for approving quality standards for imports covering 84 product items. In the field of training, the programmes offered by the SLSI on Quality Management and Quality Control provides an opportunity for entrepreneurs to acquire knowledge and skills on product quality, productivity, and environmental standards⁴⁶.

181. With the introduction of the **Provincial Council system** in the late 1980s, the public sector institutional network was further expanded by another layer at provincial level. Accordingly, Provincial Councils also have limited authority to undertake industrial promotion activities within their areas of jurisdiction. More specifically, the Provincial Councils have the authority to prepare industrial development plans, undertake research and development work, industrial promotion activities and co-ordination with other institutions functioning at central and provincial level. In actual practice however, except for the North Western Provincial Council (NWPC), many of the Provincial Councils have been neutral towards establishing their own institutional network for industrial promotion. In fact, the NWPC is perhaps the only Provincial Council, which managed to carve out its own institutional arrangements for industrial promotion in the North Western Province (NWP) demonstrating the impact of effective political leadership. This refers to the establishment of new institutions such as Industrial Services Bureau (ISB), Wayamba Quality Control Unit and Wayamba Janakala Foundation.

182. In operational terms, public sector institutions provide various types of support services to SMEs along with other administrative functions. The scope and type of support services offered by them vary from institution to institution and there is a high degree of overlap among different institutions in terms of coverage and targeting. For example, in the case of manufacturing, trade and services sectors one does not find a single major institute or group of institutions functioning under the supervision of a single institution. In the area of skills development and transfer of appropriate technology, public sector institutions (e.g., Universities and Technical Collages, IDB, SLSI, ITI, NSF, etc.) appear to function without any interaction with similar institutions in the public sector. This has resulted in duplication of work and inefficient use of public funds. It may be the case that the various agencies would like to pursue their mandated responsibilities without paying much attention to other institutions, which

⁴⁶ At present, the SLSI offers about 80 programmes per annum on Quality Management and Quality Control. It also offers a one year Diploma on Quality Management.

offer similar services. It should be recognized however, that without proper coordination, all the activities of various agencies are not adding up to generate a momentum for SME development in Sri Lanka.

183. The poor quality of institutional support could be attributed to the absence of a clear cut policy and strategy on SME development at national level. By and large, the existing policy statements express the general concern for establishing linkages between big investors and small producers, technology transfer and skills development. Existing policy documents relating to trade and industry however, state specific institutional arrangements for the development of industries in general and for the development of SMEs in particular.
184. With respect to SME policy, there is little co-ordination between the ministries in policy formulation or implementation. Several attempts to develop co-ordinated policies with joint participation of both private sector and public sector organizations (i.e., Industrialization Committee, the Advisory Council for Industry and Regional Industry Service Committee) had not been very successful due to political economy factors. Most recent efforts to prepare an overall policy framework covering at least key sectors of the economy through a central advisory body (i.e., the National Development Council) did not have the leadership and failed in spite of concentrated efforts made at the top level.

5.2 Private sector institutions supporting SMEs

185. The private sector institutions engaged in SME development could be classified into four major groups: a) Financial institutions, b) Chambers and business promotion organizations c) private sector business service providers, and d) private sector firms. The first category, **financial institutions**, refers to private sector banks and other financial institutions engaged in providing credit support and related business promotion services to SMEs. The second category, **Chambers of Commerce and Industry and other business promotion organizations**, refers to a well organized institutional network actively engaged in business promotion and development. It also includes Provincial level chambers such as Hambantota Chamber of Commerce and Industry, Wayamba Chamber of Commerce and Industry and a few other Provincial based chambers. In this regard, the Sri Lanka Chamber of Small Industry, SMED, and the recently established Federation of Small & Medium Enterprises deserve special mention in view of its SMI specific target group and initiatives to expand the regional network. These institutions offer a wide range of support services such as skills development, business management and entrepreneurship development. In addition, the Federation of Chambers of Commerce and Industry of Sri Lanka (FCCISL) has recently set up a

Regional Development Unit (RDU) to promote trade, industry and investments in the regions. However, it is important to note that the large Chambers are biased towards Colombo based enterprises rather than SMEs operating at regional level.

186. The third category, **private sector business service providers**, refers to various types of institutions which provide advisory and consultancy services in the fields of management, engineering, legal matters, product and process technology and information technology. The services of these institutions are mainly confined to the Western Province and selected urban centres in other provinces. The fourth category, refers to well established private sector organizations which offer business support services to SMEs operating outside Colombo in the areas of technical and managerial skills development, and sales and marketing. These programmes are of short duration and targeted at small-scale enterprises.

5.3 Non-government and multilateral-bilateral donor agencies supporting SMEs

187. In addition to government and private sector institutions, a large number of NGOs and Multilateral and Bilateral agencies are also involved in providing various support services to SMEs. The NGO sector in general, covers a highly diverse set of institutions representing both national and international participation in enterprise development. Most of them are confined to selected economic sub-sectors or selected administrative districts of the economy and provide skills development programmes on record keeping, accounting procedures, labour management and product development. In addition to skills development, the well established NGOs provide a wide range of consultancy and advisory services in the fields of marketing, financing, engineering and preparation of project proposals.
188. The Multilateral and Bilateral donor agencies play an important role in promoting SME sector activities in the economy. In addition to supply of low cost credit, they have been actively involved in capacity building and policy reform initiatives jointly with private sector organizations. The SMEs however, have not fully benefited by these assistance programmes due to among others, absence of an integrated development plan at national level.

5.4 An overall assessment

189. In overall terms, government sector institutions dealing with regulatory services appear to maintain less interaction with the private sector and non-government sector organizations engaged in SME development. With

respect to delivery of support services, both public and private sector institutions appear to function as independent service providers. A closer interaction between these two sets of institutions especially at the stage of initial work planning would lead to an efficient and effective system of support services.

190. The international experience relating to institutional support for SME development appear to be relevant and important for Sri Lanka. For example, in the Republic of Korea (ROK), Malaysia and Thailand, the institutional set up is simple and limited to a few institutions. In the case of India and China, the institutional structure is more complex and covers different layers of central and regional administration. Singapore has also adopted a multi-agency approach in its policy support towards SMEs. Among the countries with simple institutional framework, Malaysia operates with a single institution co-ordinating SME development efforts of various institutions enabling the government to enforce its policies more effectively and efficiently. In Thailand, the BOI and its branch offices assist industries and other SME development institutions. In ROK however, most of the institutions are NGOs. Moreover, the presence of special banks for SME development in India and ROK, is an important institutional feature worth noting. Another notable feature with respect to Malaysia and ROK is the establishment of various funds for the development of SMIs.

Table 5.1
International Best Practice – Malaysian Experience

The Government of Malaysia has set up a Central Agency for SMIs to:

1. Formulate policies for SMI development and strengthen linkages
2. Co-ordinate the programmes of a multiplicity of agencies servicing and assisting the SMIs in order to avoid duplication
3. Serve as a focal point of assistance for SMIs involving services such as a computerised data base containing information on SMIs
4. Serve as a ‘watch dog’ agency for implementation of policies and incentives of SMIs
5. Minimize the imbalance between large-scale enterprises and SMEs

Source: SMED, 1999, Small and Medium Industries – Impact of Liberalization and Constraints for Development

191. Given the continued practice of a pro-market policy regime, Sri Lanka needs to adopt supportive policies for the development of SMEs. The 'supportive policies' accept the underlying superiority of market forces but justify state intervention in economic activities due to the presence of

imperfect information and transaction costs. In practical terms, this involves enforcement of property rights, skills enhancement, entrepreneurship development and transfer of appropriate technology in order to foster the process of economic change. Its success however, depends on capacity limitations of government agencies and efficacy of the markets. In the context of SMEs, this involves implementation of an integrated institutional support system with an active participation from private sector and non-government sector organizations.

192. However, the failure of earlier efforts to come up with co-ordinated policies/strategies for industrial development, casts serious doubts as to whether any co-ordinated SME development policies can be formulated and implemented within the present structure of fragmented ministerial responsibilities for the SME sector. While it is simple to recommend that policies should be co-ordinated, in practice inter-institutional conflicts are bound to prevail on matters of policy, strategy and special development projects which cut across the narrow interests of different public sector organizations. Based on past experience, it is also clear that the government has no intention to curtail the diversity of support agencies, but it has every intention to make sure that scarce public resources are utilized in the most effective way through the existing system.
193. Of several existing studies, the Report on Employment Promotion and the Development of Micro and Small Enterprises (ILO, 1994), the Report of the Committee on a Programme for the Development of the Small and Medium Industry Sector (PDSMIS, 1995), the Master Plan for Rural Industrial Development (1998) and the JICA study on the establishment of a Small and Medium Industry Development Corporation (SMIDEC, 2001) highlighted the lack of co-ordination among public sector institutions and non-government and private sector organizations that provide support services to the SME sector. In fact, the PDSMIS recommended the need for an “SMI Promotions and Development Committee” and the need for the IDB to play a central role in implementing plans for SME development. The JICA study called for the establishment of a one stop shop, the Small and Medium Industries Development Corporation (SMIDEC, 2001). The Task Force is in principle in agreement with this recommendation. However, the integrated institution should be an independent body.
194. In terms of institutional reform, it is very unlikely that the government will take immediate action to curtail the diversity of public sector institutions engaged in SME development in spite of institutional overlap and poor targeting. Hence, building partnerships among different levels of government, the private sector, non-government organizations and Multilateral and Bilateral agencies is vital in strengthening institutional support.

195. The proliferation of public sector institutions engaged in SME development has been a result of ad hoc policy measures and short-term political motives rather than rationally planned industrial strategy. Hence, there is a clear need for establishing a 'central institution' to facilitate faster growth and expansion of SME sector activities within a pro-market policy environment.

5.5 Recommended strategies

196. In view of the above considerations the Task Force recommends the following strategies to enhance the quality of institutional support for SME development:

- Establishment of the SME Authority
- Institutional reform
- Inter-institutional Coordination
- Developing staff and institutional capacity

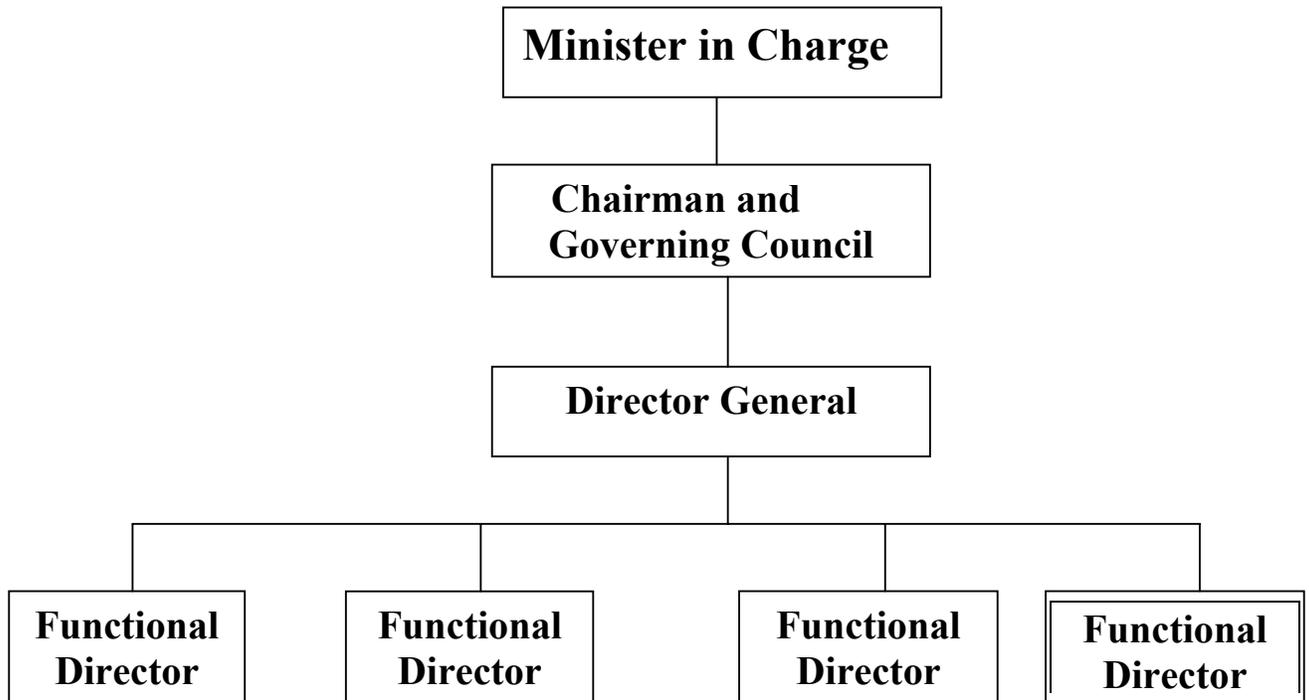
197. **The establishment of SME Authority (SMEA)** is one of the most important strategic initiatives recommended by the Task Force. The purpose was to create a powerful single-point administrative structure which can cut across administrative and financial barriers and fully implement the recommendations of the White Paper. It should also have powers to formulate policy, expedite approvals from other government agencies and resolve issues encountered during project implementation. In operational terms, the SMEA should be an independent body and should function as a **'one stop shop'** which could coordinate and facilitate licensing, registration and information delivery to SMEs.

Objectives

- a) To encourage and foster the establishment and development of industrial and commercial enterprises within the SME sector;
- b) To recommend to the Minister, national policy and strategy for SME development;
- c) To co-ordinate with government, semi-government, non-government, private sector organizations and donor agencies engaged in SME development which constitutes the integrated institutional system;
- d) To implement short, medium and long-term Action Programmes set-out in the White Paper;
- e) To identify the core competencies of institutions working for the development of SMEs;
- f) To conduct, promote and co-ordinate research in relation to SME development and to publish reports and information with respect to SMEs;

- g) To create and maintain a “Special Fund” for SME development, and;
- h) To review and monitor financing schemes and donor funding programmes for SME development in order to ensure best utilization of available funds.

Chart 1 Proposed Organization Chart – SMEA



Organizational Structure

In line with the pro-private sector economic policies promoted at national level, proposed SMEDA should be an autonomous body functioning under the purview of the Ministry of Enterprise Development, Industrial Policy and Investment Promotion. The SMEDA shall consist of a Governing Council appointed by the President in consultation with the Minister.

- a) The Secretary to the Ministry of Enterprise Development, Industrial Policy and Investment Promotion or his nominee;
- b) A Senior Representative from the Ministry of Finance;
- c) A Senior Representative from the Ministry of Industries;
- d) A Senior Representative from the Ministry of Agriculture;
- e) A Senior Representative from the Ministry of Trade and Commerce;
- f) The Chairman of the Industrial Development Board;

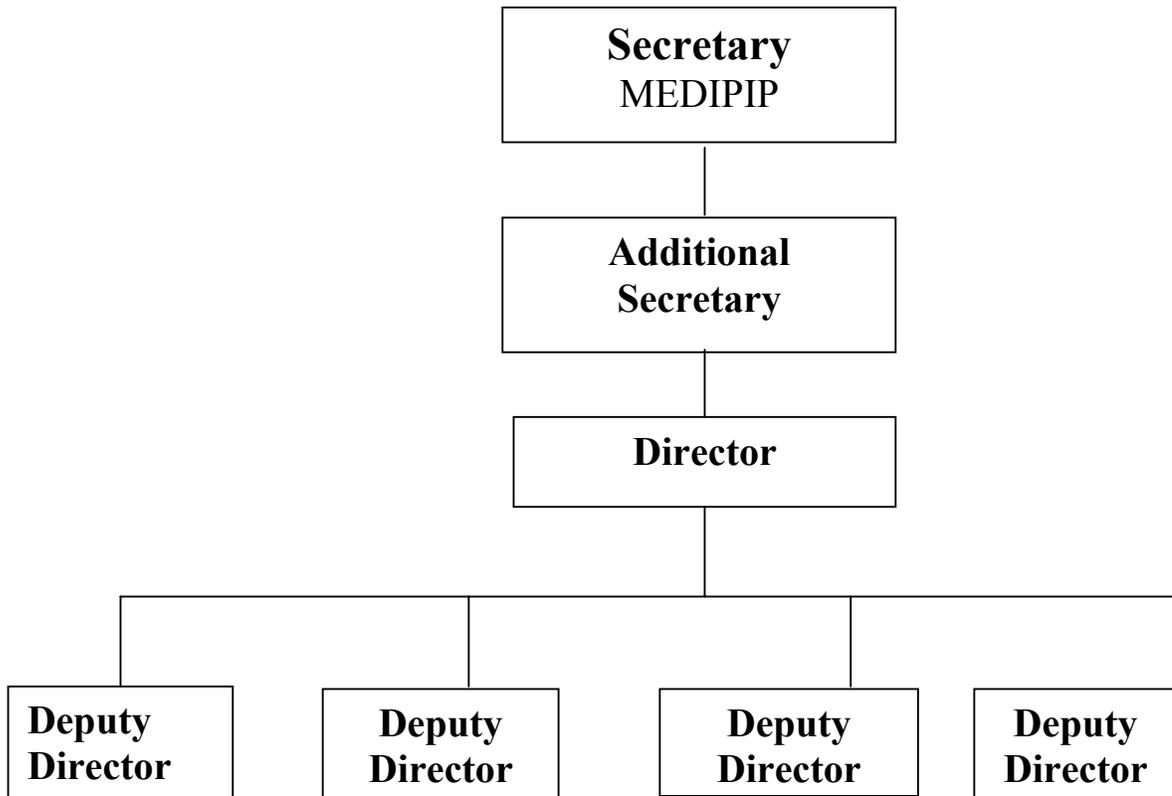
- g) One member from among Bankers and one from the Central Bank to represent the interests of both public and private sector banking organizations;
- h) Five members from among Chambers of Commerce and Industry to represent the interests of private sector organizations;
- i) Two members to represent the interests of universities and research institutions.

The President in consultation with the Minister shall appoint one of the appointed Members to be the Chairman of the SMEA based on the recommendations of the Governing Council. The Board will have powers to summon any government official to clarify and expedite matters relating to SME development.

Funding: The SMEA shall have its own Fund. The initial capital of the SMEA shall be Rs. 100 million. The amount of the initial capital shall be paid out of the Consolidated Fund in such installments as the Minister in charge of the subject of Finance may, in consultation with the Minister. For purposes of meeting recurrent expenditure the Fund shall receive money from the following sources:

- a) all such sums of money as may be voted from time to time by Parliament for the use of the SMEA;
- b) all sums of money as may be received by the SMEA by way of loans, donations, gifts, or grants from any sources whatsoever, whether in or outside Sri Lanka; and
- c) all sums of money as may be received by the SMEA as service fees.

Chart 2 Proposed Organization Chart - SMEPU



Management: There shall be a Director General of the Authority appointed by the Minister on the recommendation of the Council, who shall be the Chief Executive Officer of the Authority. The Director General shall, subject to the general direction and control of the Council, be charged with the direction of the business of the Authority, the organization and execution of the powers, functions and duties of the Authority and the administration and control of the employees of the Authority.

Interim Administrative Measures: The Task Force also recommends to establish a **SME Policy Unit (SMEPU)** as an interim administrative measure for effective co-ordination and implementation of **Action Programmes** recommended in the White Paper. The SMEPU is expected to carry out these activities until the proposed SMEA is established under a separate Act of Parliament. During this interim period, the SMEPU should function under the direction of a **Governing Council** which should consist of the current SME Task Force members. The Secretary to the MEDIPIP should be the current Chairman of the Governing Council. The purpose is to ensure continuity and ownership of work initiated by the Task Force.

198. **Institutional reform strategy** comprises of two main components: a) restructuring of the Ministry of Enterprise Development, Industrial Policy & Investment Promotion, and b) restructuring of IDB. The on going restructuring process at these two institutions needs to be continued with a clear focus on the implementation of the National SME vision and strategy. Both institutions need to deviate significantly from the traditional type organizational structure and become more development oriented.
199. The **Ministry of Enterprise Development, Industrial Policy and Investment Promotion** is recommended as the implementing agent for the National SME vision and strategy. This requires the government to give the Ministry a mandate and fund it appropriately. These issues are covered in Part 3, Section 3.1 of the White Paper and the delivery of these functions requires a flexible Ministry that works closely with other stakeholders. In the event of redefining Subjects and Functions of Ministries, the implementation of the recommendations of the White Paper should be assigned to the Ministry in charge of Industrial Policy.
200. The **IDB** has already begun the restructuring process. Accordingly, the mission of the IDB is “ *to be the self-sustaining, vibrant, premier organization in Sri Lanka for the promotion and development of Small and Medium Enterprise economic base by facilitating quality services through own expertise and private sector business development services to prospective entrepreneurs, existing industries and related businesses.*”

In line with the above mission its future tasks include the following:

- Facilitate and support the institutions working for the development of the SME sector specifically in the areas of finance, marketing, technology, mutual corporation and management systems
 - Provide guidance, assistance and promote different training programmes to meet the needs of SMEs
 - Promote research and development of SMEs
201. The aim of the restructuring process is for IDB to become more relevant to the needs of SMEs and commercially orientated. In order for IDB to become more relevant for SMEs and at the same time become a self-sustaining organisation it will need to take on several reforms. In the process of restructuring it needs to orient itself as a one-stop shop especially in facilitating Business Development Services (BDS).
202. **IDB can be most effective in BDS by stimulating the private sector** to provide services more suited to SMEs and encouraging BDS providers in more remote areas. IDB also has an important role to play in increasing rural SMEs awareness of BDS and the advantages of pursuing such services. The rationale for this is based on: a) the scarcity and low awareness of BDS providers in regions outside Colombo, b) limited available government funds, and c) international best practice in BDS. In addition, the EDB could also play an important role in promoting SME development particularly in the area of access to foreign markets. The SLSI and ITI are yet another two institutions which could further strengthen BDS network for SME development.
203. The **co-ordination strategy** involves a series of activities aimed at establishing institutional links both at central and regional level. The implementing Ministry for the national SME strategy should play a key role in bringing together different organisations delivering services and assistance to SMEs. The Ministry must take the lead in setting the overall agenda for SMEs policy and be responsible for involving all players. Such a role should include:
- Liaising with other ministries and public sector institutions to fine tune strategy.
 - Disseminating information about the state of SMEs in Sri Lanka.
 - Take advice from industry and other stakeholders in the designing and implementation of policies and programmes relating to SME development.
204. At Provincial level some amount of institutional transformation and co-ordination is needed in line with the zonal approach adopted by the new government in its efforts towards regional development. The Chambers of Commerce and Industry have already established regional branches to

promote regional level industries. This trend needs to be continued with active support from NGOs and Multilateral-Bilateral organizations. As a part of this strategy the Ministry and other key stakeholders need to come up with a strategy to further strengthen inter-institutional coordination at Provincial level. In operational terms, this involves reactivating regional level co-ordinating bodies such as Regional Industry Service Committees (RISC) and introduction of similar co-ordinating bodies to address sub-sector specific issues and provincial/regional level issues (i.e., North and East). It also involves specific measures to enhance quality of services offered by various institutions engaged in technical education, science and technology, access to foreign markets e.g., Technical Collages, ITI, NSF, NERD, EDB and Universities.

205. The Chambers of Commerce and Industry and multilateral and bilateral organizations also need to play an active role in promoting inter-institutional co-ordination for SME development. With respect to the former, the institutional network of the Chambers of Commerce and Industry and its links with the business sector need to be redirected to promote SME sector activities jointly with the proposed SMEPU/SMEA. Similarly, multilateral and bilateral organizations, need to channel their support including both funding and advisory services for SME development through the proposed SMEPU/SMEA in order to ensure optimal use of foreign resources. In fact, the pro-business policy regime provides the ideal conditions for both private sector and donor agencies to make a joint effort in the implementation of the recommendations of the White Paper.
206. **Developing staff and institutional capacity** is primarily aimed at staff development and capacity building of both public sector and private sector institutions engaged in SME development. More specifically, this involves the following programme of activity:
- Strengthen SME Policy unit of the implementing ministry in the areas of database management, dissemination of information, policy analysis, performance monitoring and inter and intra-institutional co-ordination.
 - Special programme on SME Development targeted at officials engaged in SME development in order to become client orientated. The target group should include officials of both public sector and private sector institutions dealing with SME sector enterprises.
 - Special programme to familiarize the officials of the IDB on its new responsibility as a facilitator of BDS and as a ‘one stop shop’.

Recommendation 15

- 1. The SMEA should share information, liaise and coordinate activities with NGOs, Chambers of Commerce and donors actively involved in the SME sector.**
- 2. IDB should map out and implement a detailed plan for moving from its existing position to a new position as facilitator and information provider.**
- 3. In order for IDB to undertake newly assigned functions, the following amendments should be made to the IDB Act: a) To help in the restructuring process, the Board should be enlarged with new members coming from the private sector, b) Allow IDB to disinvest itself of assets and divisions it regards as no longer central to its key functions.**
- 4. Establish close links between BDS providers (e.g. IDB, EDB SLSI, ITI, etc.,) engaged in SME development especially at regional level.**
- 5. Effective use of regional chamber network to promote SME development at regional/district level.**

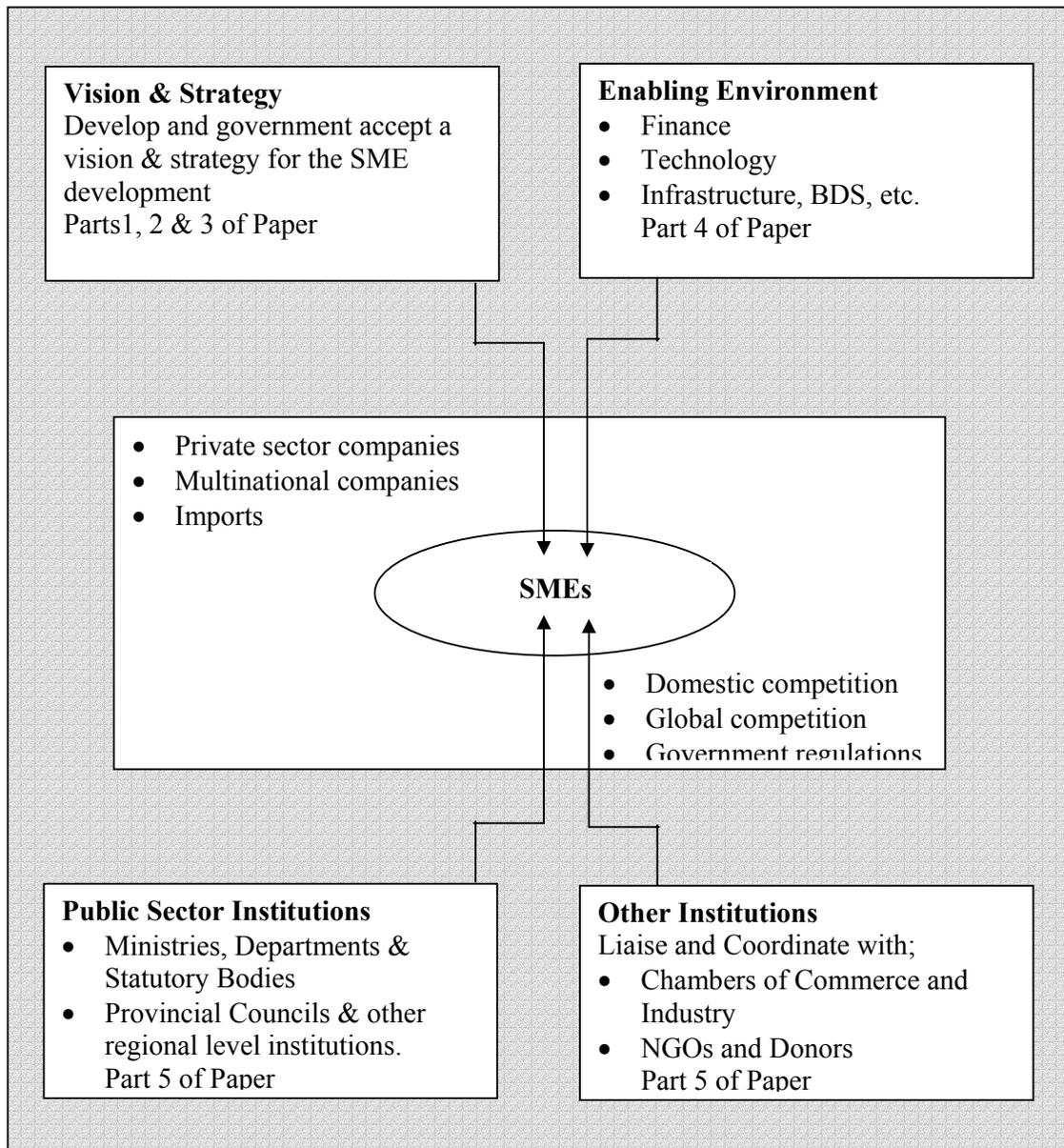
PART SIX

Action Program

6.1 An integrated view

207. In this part of the White Paper we bring together its various elements itemized in the previous five parts. An initial attempt is made at establishing a time frame for implementing the strategy and action programmes for the next eight years. As the strategy is implemented, it is expected that the time frame may need to be revisited in response to new developments and actual achievements.
208. In order to gain an overall perspective of the national strategy, the diagram below sets out the links between the various components of the strategy. At the centre of the diagram the business environment within which SMEs operate is depicted. Accordingly, SMEs work in an environment dominated by national and global competition from large national firms and multilateral corporations. Rapidly changing international trade and competition as well as national government institutions, legislative and regulatory environment and judiciary framework also effect the operations of SMEs.
209. The national strategy for SME development addresses the need for action with respect to 14 strategic elements:
- Public policy
 - Institutional reform
 - Coordination
 - Developing staff and institutional capacity
 - Financing
 - Technology
 - Access to information and markets
 - Business development services
 - Linkage formation
 - Infrastructure
 - Regulatory framework
 - Industrial relations and labour
 - Entrepreneurship skills and retraining
 - Environmental issues

210. The action plan presents the specific actions needed and feasible to implement the above strategic elements in terms of short (2003), medium (2004-5) and long-term (2006-10) dimensions of the overall strategy. It also sets out the time targets and institutions responsible for project implementation.
211. For effective implementation of the Action Plan, the Ministry of Enterprise Development, Industrial Policy & Investment Promotion must commit appropriate resources and establish a fully equipped SME Policy Unit staffed by professional and necessary administrative staff.



6.2 Short term – end of 2003

Strategic Element	Action	Responsibility	Time Target
S1. Public Policy	1. Establish SME Policy Unit	MEDIPIP	2Q, 2003
	2. Establish SME Development Authority	MEDIPIP	2003
	3. The government and relevant ministries adopt the vision for the SME sector as set out in the White Paper on SME development in order to provide direction for an overall strategy and plans for implementation	SMEA/ SMEPU, MERST, MPDI	2Q, 2003
	4. The Ministry in charge of Industrial Policy will be the implementing agent for the national strategy of SME development	SMEA/ SMEPU	2 Q, 2003
	5. Provide recognition and usage of SME definition given in the White Paper by all concerned institutions	SMEA/ SMEPU	2Q, 2003
	6. Business incubation promotion	M I, IDB	2Q, 2003
	7. Ensure policy reforms in education, develop strategies for training in entrepreneurship and technical and management skills	MHRDECA, MSE, MTET	2Q, 2003
	8. Require government organizations to follow established administrative procedures to provide maximum benefits to SMEs. 8.1 Advertise government's routine procurement requirements at the beginning of the year 8.2 Implementation of Public Finance Circular No. 352 (16) for the purpose of applying domestic preference 8.3 Reservation of items for local suppliers with staggered delivery	MEDIPIP, SMEA/ SMEPU, MERST, MPDI	2Q, 2003
	9. Obtain WTO concessions for SME development 9.1 Obtain maximum WTO concessions for service industries 9.2 Obtain WTO/GATT concessions for manufacturing industries	DCOM	2 & 3 Q, 2003
	10. Introduce a simplified tax system for the SMEs 10.1 Introduce a simple accounting system 10.2 Simplify detailed profitability calculations 10.3 Lower tax rates for SMEs at Provincial level 10.4 Allow Registered Auditors to certify accounts of SMEs	ICA	2 Q , 2003

S2. Institutional Reform	1. Continue on going restructuring initiatives of the Ministry of Enterprise Development, Industrial Policy & Investment Promotion	MEDIPIP	2Q, 2003
	2. Facilitate restructuring activities of the IDB with necessary funding and administrative support	MEDIPIP	2Q, 2003
	3. Prepare a detailed plan for the IDB to move from its current position to a new role as a facilitator and information provider to SMEs	IDB	2Q, 2003
S3. Coordination	1. Continue with Industries Facilitation Forum as a mechanism to address inter-institutional issues relating to SMEs	MEDIPIP	2003
	2. Initiate sector specific policy support for SMEs jointly with sectoral plans developed by the implementing Ministry	SMEA/ SMEPU	2Q, 2003
	3. Establish links with other institutions engaged in SME development	SMEA/ SMEPU	2Q, 2003
S4. Developing staff and Institutional capacity	1. Capacity and competency building of institutional players at regional level	MEDIPIP, Chambers NGOs, MRD	2003
	2. Workout a special package of support services to strengthen capacity and competency of institutions assisting SMEs in the North and East	MEDIPIP, Chambers, NGOs, MRD	2003
	3. Educate officials at regional level (i.e., the Dept. of Inland Revenue, Dept. of Labour, CEA, CEB and Provincial Councils) about the institutional support for SME development	SMEA/ SMEPU, Chambers, NGOs, MRD	2003
	4. Provide special training on enterprise development and public relations to public officials engaged in SME development	SMEA/ SMEPU, MRD, PCM, Chambers	2003
S5. Financing	1. Implement low cost credit negotiation and project monitoring activities initiated by the IDB	IDB SMEA/ SMEPU	2003
	2. Parate execution laws to be revised considering the concerns of SMEs and high bias towards lending institutions	MF, SMEA/ SMEPU.	2003
	3. Encourage active participation of Venture Capital Companies and Leasing Companies to provide credit support for SMEs	MF SMEA/ SMEPU	2003

	4. Disburse loan and allied facilities with the assistance of BDS providers	SMEPU SMEA IDB	2003
	5. Simplification of credit appraisals, collateral requirements and approval procedures	SMEA/ SMEPU, BISL	2003
	6. Explore the possibility of introducing an effective Credit Guarantee Scheme and Equity Investment Scheme for SMEs	SMEA/ SMEPU, BISL	2003
	7. Facilitate SMEs operating in industrial estates to use their land as a bankable asset	MEDIPIP	2003
	8. Take remedial measures to solve the problem of under-valuation of land in the North & East	MEDIPIP, MRD	2003
	9. Request government institutions to minimize delays in making payments to SMEs for supply and services	SMEA/ SMEPU, MF	2Q, 2003
	10. Install good financial discipline	SMEPU SMEA, FIs	2003
S6. Technology	1. Establish 'Technical Service Centres' at the district level	SMEA/ SMEPU, IDB, ITI, MERST, MRD, BDSP, Chambers	2Q, 2003
	2. Establish a 'Technology Development Fund' at the district level	MF, SMEA/ SMEPU, NGOs	2003
	3. Provide financial assistance to SMEs to update/ acquire new technology	MF, SMEA/ SMEPU	2Q, 2003
	4. Create market for local R&D 4.1 Educate SMEs on existing legal and regulatory provisions to protect innovations 4.2 Provide grants/awards and other incentives for local R&D institutes developing SME friendly innovations 4.3 Introduce incentives for universities to play an active role in SME related innovations	MEDIPIP, MSCT, MTET, MHRDECA, Chambers	2003
	5. Introduce a voucher scheme to promote R&D work among SMEs.	SMEPU/ SMEA, IDB	2003

S7. Access to Information and Markets	1. Commission a survey and a magazine on SMEs on annual basis	SMEA/ SME PU, DCS, CB, Chambers	2003
	2. Create a SME Web site with a view to provide e-business facilities and other information at Divisional Secretariat / Chambers and other Associations	SMEA/ SMEPU, IDB, EDB NOR	2003
	3. Provide opportunities for SMEs to participate in trade promotion exhibitions in foreign and local markets	SMEA/ SMEPU, EDB, IDB DCOM, Chambers	2003
	4. Initiate low cost advertising and sales promotion programmes for SMEs	MEDIPIP, MMC, IDB	2003
	5. Provide access to foreign markets through e-commerce facilities	MCOM, EDB, SPX	2003
	6. Provide sales and marketing facilities for SMEs at tourist resorts e.g., organize exhibitions	MT, EDB MEDIPIP, MAL	2003
	7. Identification of export oriented projects for SMEs	EDB, Chambers	2003
	8. Create Virtual markets 8.1 Coordinate virtual trade fairs and exhibitions annually 8.2 Coordinate with banks for e-transactions for those who do business through virtual market	SMEA/ SMEPU, EDB, SPX, Chambers	2003
S8. BDS	1. Maintain a comprehensive and up-to-date BDS data base	MEDIPIP	2003
	2. Introduce a Voucher scheme for SMEs to promote BDS	MEDIPIP MI, IDB, Chambers	2003
	3. Encourage BDS providers in the areas of e-commerce (i.e., e-advisory services, e-communication services, e-promotional services), training on import/export procedures and international trade, advice on policy related issues, product markets and preparation of technical reports.	MEDIPIP, IDB, EDB, NGOs, Chambers	2003
	4. Create awareness on BDS among SMEs	SMEPU/ SMEA, IDB, Chambers	2003
	5. Promote business incubator programmes	SMEPU/ SMEA, MI, IDB, Chambers	2003

S9. Linkage formation	1. Form 'Industry Clusters' on industry sub-sector basis	MEDIPIP, SPX, UNIDO	2003
	2. Promote subcontracting with proper targeting for improving the technological capabilities of SMEs	SPX, IDB, SMEDA/ SMEPU	2003
	3. Establish business linkages between SMEs and large scale buyers in Sri Lanka and abroad	UNIDO, NGOs, EDB, SPX, Chambers	2003
S10. Infrastructure	1. Creation of industrial parks for SMEs in rural areas	BOI, SMEA/ SMEPU	2003
	2. Facilitate access to unutilized government buildings for SMEs	MEDIPIP MI, MRD	2003
S11. Regulatory Framework	1. Amend the Companies Act with a view to facilitate SME development	DCOM	2Q, 2003
	2. Effective implementation of Anti-Dumping Laws jointly with the following institutional arrangements: 2.1 Director General of Sri Lanka Customs functioning as a member of SMEPU 2.2 Prohibit under invoicing	DCOM DoC SMEPU	2003
	3. Release SMEs from labour and tax regulations for the initial three years of business operations	MF, DEL.	1&2 Q, 2003
	4. Gradual reduction of import duties on intermediate inputs and duty free raw materials	SMEPU, TAC	2003
	5. Take remedial measures to avoid duty anomalies relating to import of raw materials and spare parts	MEDIPIP	2003
	6. Duty on imported machinery to be reduced while promoting local industries engaged in the manufacture of machinery e.g., enhanced capital allowance.	MEDIPIP	2003
	7. Amend the National Environmental Act with a view to ensure that the approval of the Central Environment Authority is final and avoids constraints imposed by other regulations e.g., the Public Nuisance Act or the Local Bodies Act.	MENR, SMEA/ SMEPU	2003
	8. Facilitate use of State land for SME projects in the Provinces	ML SMEA/ SMEPU	2003
	9. Introduce a reward system for SMEs who pay taxes and fulfil other regulatory requirements e.g., green channel facilities	MF SMEA/ SMEPU	2003
	10. Promote deregulation particularly in high value added sub-sectors of the economy e.g., mineral processing industry	MEDIPIP	2Q, 2003

	11. Develop a national policy on Construction Industry and introduce a separate Bill to promote business activities of the Construction Industry	MHPI SMEDA/ SMEPU	2003
	12. Request government organizations to follow established administrative procedures to provide maximum benefits to SMEs	SMEPU/ SMEA, MF	2003
S12. Industrial relations and labour	1. Implementation of proposed labour reforms	MEL, MEDIP	2003
S13. Entrepreneurship skills, re-training and management	1. Conduct skill development programmes with sub-sector specific focus	Chambers, NGOs, ILO, IDB, EDB	2003
	2. Provide training for SME owners on joint ventures / partnerships and financial management	Chambers, NGOs, CSE	2003
	3. Organize productivity enhancement programmes for SMEs	NPS, IDB	2003
	4. Promote industry specific technical training jointly with sub-sector specific institutions e.g., Gem and Jewellery Institute (GJI).	EDB, IDB and others	2003
	5. Encourage Universities and other tertiary sector institutions to provide training support for SMEs	MTET, SMEA/ SMEPU	2003
	6. Introduce a voucher system as a strategy to promote skill development among SMEs	SMEPU/ SMEA, MEL	2003
	7. Implement policy reforms proposed for tertiary education	MEL, MTET, SMEPU/ SMEA	2003
S14. Environmental Issues	1. Enhance the capability of government and private BDSs to assist SMEs in cleaner production and environmental management	MENR, SMEPU/ SMEA	2003
	2. Facilitate EIA requirements by providing technical advice and testing services for SMEs operating at regional level	MENR, MERST, NCPC, ITI, SMED	2003
	3. Awareness programme on cleaner production targeted at regional level SMEs	NCPC, MENR SMEPU/ SMEA	2003
	4. Encourage environment related business activities such as eco-tourism and geo-tourism	MT, GSMB	2003

	5. Develop alternative guarantee schemes for SMEs interested in low cost abatement technologies	SMEPU FIs	2003

6.3 Medium term – 2004 to 2005⁴⁷

Strategic Element	Action	Responsibility	Time target
M1. Public Policy	1. Review macro issues affecting the growth and development of SMEs	SMEA/ SMEPU	2004/5
	2. Introduce new policies to meet current challenges of the business environment	SMEA/ SMEPU	2004/5
M2. Institutional Reform	1. Review the process of SME strategy implementation with a view to provide remedial measures and adjust to current developments	SMEA/ SMEPU	2004/5
	2. Allow IDB to become an autonomous institution	MEDIPIP	2004
	3. Facilitate restructuring activities of the IDB with necessary funding and administrative support	MEDIPIP,	2004
M3. Co-ordination	1. Establish links with other institutions engaged in SME development	SMEPU/S MEA	2004/5
M4. Developing staff and Institutional capacity	1. Capacity and competency building of institutional players at regional level	Chambers	2004
	2. Improving the database of the implementing Ministry to fulfil information requirements of other stakeholders. Monitor database expansion.	MEDIPIP	2004/5
M5. Financing	1. Encourage active participation of Venture Capital Companies and Leasing Companies to provide credit support for SMEs	MF SMEA/ SMEPU	2004
	2. Disburse loan and allied facilities with the assistance of BDS providers	SMEPU SMEA IDB	2004
	3. Install good financial discipline in SMEs	SMEPU SMEA, FIs	2004

⁴⁷ In view of procedural delays and politico-economic uncertainties in the domestic front and turbulent business environment at global level, the task force decided to include some of the short-term action programmes under the Medium-term Action Plan as well. The purpose is to ensure that the key recommendations given in this White Paper are implemented during the initial two years of project implementation.

	6. Explore the possibility of introducing an effective Credit Guarantee Scheme and Equity investment scheme for SMEs	SMEA/ SMEPU, BISL	2004
M6. Technology	1. Strengthen technical service centres at regional level	IDB, ITI, MERST, MRD	2004/5
	2. Maintain 'Technology Development Funds' established at district level	NGOs	2004/5
	3. Continue with sector specific efforts to develop technology	IDB,ITI	2004
	4. Provide opportunities for SMEs to have access to foreign technology by organizing visits to foreign countries and demonstrations at regional/district level	IDB	2004/5
M7. Access to Information and Markets	1. Expand EDB information system to feed information centres at regional level	EDB	2004
	2. Maintain a 'Regional Information Network' system to provide e-business facilities and other information at Divisional Secretariat / Regional Chambers level	SMEA/ SMEPU, IDB	2004/5
	3. Provide opportunities for SMEs to participate in trade promotion exhibitions in foreign and local markets	IDB,EDB, NGOs, Chambers	2004/5
	4. Continue with low cost advertising and sales promotion programmes for SMEs	MEDIPIP	2004
	5. Identification of export oriented projects for SMEs	EDB, NGOs	2004
M8. BDS	1. Update BDS directory	MEDIPIP	2004/5
	2. Educate SMEs on the benefits of BDS providers	MEDIPIP MI, IDB	2004/5
	3. Stimulate the demand for BDS	MEDIPIP MI, IDB, EDB	2004/5
M9. Linkage formation	1. Form 'Industry Clusters' on industry sub-sector basis	Chambers	2004
	2. Promote subcontracting with proper targeting for improving the technological capabilities of SMEs	SE	2004
	3. Establish business linkages between SMEs and large scale buyers in Sri Lanka and abroad	UNIDO, NGOs	2004
	4. Provide incentives to large scale manufacturers to sub-contract their work to SMEs	MEDIPIP	2004
M10. Infrastructure	1. Creation of industrial parks for SMEs in rural areas	IDB	2004
M11. Regulatory	1. Promote deregulation with a clear focus on emerging competitive trends and development needs of the national economy	MEDIPIP, MERST	2004

Framework	2. Address duty anomalies relating to import of machinery, raw materials and finished products	TAC, SMEDA/ SMEPU	2004
M12. Industrial relations and labour	1. Implementation of proposed labour reforms	MEL	2004/5
M13. Entrepreneurship skills, re-training and management	1. Educate SME workers on productivity and competitiveness of SMEs	NPS	2004
	2. Promote entrepreneurship skills among SME owners	MEDIPIP, IDB, EDB	2004
	3. Promote industry specific technical training jointly with sub-sector specific institutions i.e., Gem and Jewellery Institute (GJI).	IDB and others	2004
	4. Encourage Universities and other tertiary sector institutions to provide training support for SMEs	MTET, SMEA/ SMEPU	2004
M14. Environmental Issues	1. Establish close links between SME Policy Unit and Cleaner Production Policy Unit of the implementing Ministry	MEDIPIP	2004
	2. Integrate Cleaner Production policies and strategies into the national industrial policy framework and SMEs strategy	MEDIPIP	2004
	3. Facilitate EIA requirements by providing technical advice and testing services for SMEs operating at regional level	MENR, CPU	2004/5

6.4 Long term – 2006 to 2010⁴⁸

Strategic Element	Action	Responsibility	Time target
L1. Public Policy	1. Review medium term strategies and provide policy support as necessary.	SMEA	2006/8
	2. Review macro issues affecting growth and development of SMEs	SMEA	2006/8
L2. Institutional Reform	1. Review medium term strategies and provide institutional support as necessary.	SMEA	2006/7

⁴⁸ By and large long-term action programmes depend on international and national events, and results achieved in short and medium-term action plans. Accordingly, a thorough review of medium-term action programmes have been included as a major activity for the Long-term Action Plan.

L3. Co-ordination	1. Identify inter and intra-institutional co-ordination problems and develop appropriate strategies and action programmes	SMEA	2006/7
L4. Developing staff and Institutional capacity	1. Carry out an institutional audit and develop alternative strategies for staff development and capacity building of institutions engaged in SME development	SMEA	2006/7
L5. Financing	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/7
L6. Technology	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/7
L7. Access to Information and Markets	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/7
	2. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/7
L8. BDS	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/7
L9. Linkage formation	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/7
L10. Infrastructure	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/8
L11. Regulatory framework	1. Review the progress of medium term regulatory reforms and develop appropriate strategies and action programmes	SMEA	2006/7
L12. Industrial relations	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/8
L13. Entrepreneurship skills and retraining	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/7
L14. Environmental issues	1. Review the progress of medium term action programmes and develop appropriate strategies	SMEA	2006/7

PART SEVEN

Funding the Implementation of the Strategy

212. This section of the White Paper deals with financial resources required for the implementation of the proposed national strategy. As stated in the main body of the White Paper, the strategy formulation is based on the policy of “maximum support and minimum intervention.” Accordingly, the government plays largely a facilitative and co-ordinating role while the private sector, non-government sector and the donor community is expected to play a major role at the implementation stage of the national strategy. The SMEs are also expected to be proactive in bringing about the changes necessary, working in partnership with each other and the government.
213. All the action programmes proposed by the White Paper do not have cost implications. Some of the policy reforms relating to employment and labour, education, power and energy and transport come under macroeconomic policy reforms and the government has already taken action to implement them. For example, Budget Proposals for 2003, spell out funding arrangement for the Human Resource Endowment Fund, Infrastructure and Corporate Restructuring Fund, Road Fund, etc., to address some of the sector specific issues. It also contains proposals for restructuring of some of the vital sectors such as electricity. Moreover, recommendations relating to streamlining some regulations and procedures and coordination with on going policy reform programmes do not require major resource commitments. However, the following are some of the major recommendations which require substantial financial resources and need to be treated as core elements of the overall strategy.
- Establishment of SMEPU
 - Establishment of the SMEA
 - Developing staff and institutional capacity
 - Establishment of a “Technology Development Fund.”
 - Establishment of “Technical Service Centres” at the district level
 - Creating an SME website
 - Facilitating restructuring activities of the IDB

214. Funding for some of the above activities (e.g., SMEPU, SME website, etc.) will be available from the ADB as a part of technical assistance for SME development. More specifically, a US\$6 million investment loan for the consulting contracts and procurement associated with the Business Services Support Facility and some portion of a US\$20 million policy loan to support reforms could be used to establish proposed SME website and technical service centres at district level. However, additional funding is needed to fully implement these proposals.
215. The costs involved in setting up the proposed SMEA however, will have to be met by the government budgetary allocations with some assistance from the donor community. The estimated initial capital for this purpose is about Rs. 100 million and recurrent expenditure is in the region of Rs. 60 million per annum. These investments are well justified in view of potential socio-economic benefits associated with SME development i.e., reducing poverty, unemployment and inequality. Proposed SMEA has a vital role to be played in this regard as a facilitative and co-ordinating body of SME development. Some support from the donor community however, is also needed particularly in the area of capacity building. Once the SMEA is established it is essential to train the staff for effective implementation of the Action Plan spelt out in the White Paper.
216. Currently, there are several Donor Agencies actively involved in SME development. Some of the major organizations include, Asian Development Bank, World Bank, IMF, USAID, UNIDO, UNDP, ILO, JICA, etc., while there are many others engaged in SME development. There are also many NGOs including the GTZ, promoting SME sector activities. These donors and NGOs have access to both financial resources and expertise. The SMEPU/SMEA will need to closely liaise with donors to incorporate them into the national strategy and take advice on implementation.
217. As noted in Chapter 5, there are several institutions – government sector organizations, NGOs, private sector institutions and multilateral and bilateral organizations - engaged in SME development. The SMEPU/SMEA as the key institution for overall co-ordination and policy support should ensure that the contributions from diverse institutional sources are directed towards optimal use. The specific action programmes required for this purpose covering a period of eight years (2003 - 2010) is given in the Action Plan.
218. The active role assigned to private sector organizations in implementing the national strategy for SME development cannot be over emphasized. The Chambers of Commerce and Industry with their regional network is well placed to promote SMEs under a pro-private sector policy regime. The SMEPU/SMEA has the primary responsibility of establishing close

links with Chambers of Commerce and Industry and other Trade promotion Organizations and finally building public-private partnership in SME development.

219. Similarly, there are many government sector organizations involved in SME development work at national, provincial and district level. These efforts need to be properly targeted and well coordinated for optimum use of scarce resources. The SMEPU/SMEA should work in partnership with these existing networks to deliver the national strategy. This has the advantage of reducing financial burden on the government in addition to promoting private sector participation in economic development.
220. From the Action Plan spelt out in the White Paper, it is explicit that substantial amount of financial resources are required to implement proposed recommendations for SME development. In spite of the support from the donor community, NGOs, the private sector organizations and government organizations, every effort need to be made to find alternative and innovative funding sources to ensure successful implementation of national strategies. In addition, limitations in available financial and human resources will necessarily mean prioritising actions required in the national strategy. Therefore, this gives an additional responsibility to the SMEPU/SMEA to operate as a fund-raising as well as fund management agency.

Appendix 1 Public Hearings

Date	Venue	No. of Participants
11 th May, 2002	Kandy	95
1 st June, 2002	Matara	94
19 th June, 2002	Colombo	37
6 th July, 2002	Trincomalee	58

Appendix 2 List of Task Force Members

	Nominee	Designation/ Institution	Address	Tel. No
1.	Dr. Saman Kelegama	Executive Director, Institute of Policy Studies of Sri Lanka (Chairman)	99, St. Michael's Road, Colombo 03.	431368 431395 (Fax)
2.	Mr. Ranjith Fernando	Secretary Ministry of Enterprise Development, Industrial Policy & Investment Promotion	73/1, Galle Road Colombo 3.	435372 449402 (Fax)
3.	Mr. Roy Jayasinghe	Addl. Secretary, Ministry of Enterprise Development, Industrial Policy and Investment Promotion (Member)	73/1, Galle Road, Colombo 03.	333341 333341 (Fax)
4.	Mr. Edgar Gunatunga	Chairman Sampath Bank Ltd. (Member)	110, Sir James Pieris Mawatha, Colombo 02.	300260
5.	Mr. K.P.N.S. Karunagoda	Snr. Asst. Director, Central Bank of Sri Lanka. (Member)	Janadhipathi Mawatha, Colombo 01.	477838 477348 477725 (Fax.)
6.	Mr. S.J. Silva	Deputy. Director - Policy, Sri Lanka Export Development Board (Member)	42, Navam Mawatha., Colombo 02.	300729/30 300715 (Fax)
7.	Mr. Nihal Fonseka	General Manager (CEO), DFCC Bank (Member)	73/5, Galle Road, Colombo 03.	440366
8.	Mr. A.K.Ratnarajah	Senior Vice Chairman, The Ceylon National Chamber of Industries (Member)	Flat No.20, First Floor, Galle Face Court 2 Colombo 03.	595592 0777-884913
9.	Mr. Chandra J. Embuldeniya	President, The National Chamber of Commerce of Sri Lanka (Member)	450, D.R.Wijewardena Mawatha, Colombo 10.	585212, 689805 689805
10.	Mr. Nihal Abeyssekera	National Project Director/UNIDO Senior Vice President of FCCIL & Chairman of the Project SMED, Federation of Chambers of Commerce & Industry of Sri Lanka (Member)	Level 3, 53, Vauxhall Street, Colombo 02.	304287 585931 072-243395 587137 (Fax)
11.	Mr. Aloy R. Jayawardena	President Sri Lanka Chamber of Small Industries (Member)	126, 10 B, Level 01, YMBA Bldg., Colombo 01	424505 071-722103
12.	Mr. Kosala Wickramanayake	President / Managing Director, Kosala Ltd. (Member)	09, 3 rd Floor, Galle Face Court 1, Colombo 03.	438715
13.	Mr. G. Gunawickrema	Addl. Secretary / SME , Ministry of Enterprise Development, Industrial Policy & Investment Promotion (Member)	73/1, Galle Road Colombo 3.	542708
14.	Dr. Bandula Perera	Chairman Industrial Development Board (Member)	615,Galle Road, Katubedda, Moratuwa.	605857 Res. 869281 0777-418977
15.	Mr. Walter A. Gunawardena	Vice Chairman – Sri Lanka Chamber of Small Industries	126, 10B, Level 01, YMBA Bldg. Colombo 01.	697692

Appendix 3 List of Support Staff to the Task Force

<u>Members Co-opted</u>				
1.	Ms. Shihana Samad	Research Assistant Institute of Policy Studies of Sri Lanka	99, St. Michael's Road, Colombo 3.	431368 431395 (Fax)
2.	Mr. Aravinda Perera	Asst. General Manager Sampath Bank Limited	110, Sir James Pieris Mawatha Colombo 2.	075-331459 400144 (Fax)
3.	Mr. E.M. Wijethilaka	Deputy Secretary General The National Chamber of Commerce of Sri Lanka	450, D.R. Wijewardena Mawatha, Colombo 10.	689805 989696 (Fax)
4.	Ms. Malathy Knight-John	Research Fellow Institute of Policy Studies of Sri Lanka	99, St. Michael's Road, Colombo 3.	431368 431395 (Fax)
5.	Ms. Thushari De Zoysa	Research Officer Institute of Policy Studies of Sri Lanka	99, St. Michael's Road, Colombo 3.	431368 431395 (Fax)
<u>Consultants</u>				
1.	Dr. Sunil Chandrasiri	Main Author Department of Economics University of Colombo	Colombo 3.	582660
2.	Dr. Athula Ranasingeh	Consultant Department of Economics' University of Colombo	Colombo 3.	582660
3.	Mr. Mahinda Gunasekera	Consultant Enabling SME Growth Project	38A, Blue Lotus Road Suwarapola, Piliyandala.	0777-672427 615449
4.	Ms. Shenuka Chanmugam	Co-ordinator from Asian Development Bank	Asian Development Bank Resident Mission, 49/14, Galle Road, Colombo 3.	387055
5.	Mr. Peter Van Diermen	Consultant from Asian Development Bank	Asian Development Bank Resident Mission, 49/14, Galle Road, Colombo 3.	387055
<u>Secretariat</u>				
1.	Ms. Menike Chandrasiri	Director/Macro Policy Division Ministry of Enterprise Development, Industrial Policy & Investment Promotion (Secretary/Convenor)	73/1, Galle Road, Colombo 3.	436122 347393 (Fax)
2.	Mr. S. Hettiarachchi	Deputy Director Ministry of Enterprise Development, Industrial Policy & Investment Promotion	73/1, Galle Road, Colombo 3.	436122 347393 (Fax)