

SUMMARY POVERTY REDUCTION AND SOCIAL STRATEGY

Country:

Sri Lanka

 Project Title:

Small and Medium-Sized Enterprises Line of Credit Project—Additional Financing
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Lending/Financing Modality:

Financial intermediation loan

 Department:

South Asia Department
Public Management, Financial Sector and Trade Division

I. POVERTY AND SOCIAL ANALYSIS AND STRATEGY

Poverty targeting: general intervention

A. Links to the National Poverty Reduction and Inclusive Growth Strategy, and Country Partnership Strategy

The additional financing of \$75 million is in response to the government's request for additional funding given the strong performance of the Small and Medium-Sized Enterprises (SMEs) Line of Credit Project, which is expected to be fully disbursed in 2018, 2 years ahead of its intended final disbursement. SMEs are important drivers of economic growth and poverty reduction through their impact on individual incomes and employment creation, contributing almost 50% to the gross domestic product. The project aims to develop the finance sector with a particular focus on SMEs to better meet the large and growing demand for SME financing. The additional investment is consistent with one of the outcomes of the country operations business plan, 2018–2020^a of the Asian Development Bank (ADB) for Sri Lanka—to strengthen regional plantation companies and SMEs' ability to access private investment from capital markets—and is aligned with the government's plan to concentrate on developing the sector by providing financial, marketing, and other related facilities to develop such enterprises.^b The project is consistent with ADB's Strategy 2020 and its country partnership strategy, 2018–2022 for Sri Lanka under Pillar 2: improve the quality of growth by promoting inclusiveness.^c The project will help overcome sustained regional disparities in income, and gender inequality in employment, by encouraging financial institutions to lend to the underserved.

B. Results from the Poverty and Social Analysis during Project Preparation or Due Diligence

1. **Key poverty and social issues.** Although Sri Lanka has been able to reduce the share of the population living below the national poverty line (\$1.48/day) from 22.7 % in 2002 to 6.7% in first quarter of 2017,^d regional development disparities continue. Western Province, which includes Colombo, has the highest per capita income and in 2013 recorded the lowest poverty incidence at less than 3%. North District recorded 12.8% and East District recorded 14.8%. The labor force participation rate in first quarter of 2017 is 54.7%, with male labor participation at 75.1%, and female labor participation at a very low 37.6%.^e While SMEs have been recognized as vital to the reduction of unemployment, inequity, and poverty, several business constraints have hindered their growth—(i) lack of access to finance, (ii) inconsistent economic policies, (iii) lack of access to technology, and (iv) lack of managerial skills required for business development.^f

2. **Beneficiaries.** The primary project beneficiaries are also SMEs, especially new borrowers, borrowers without collateral, borrowers outside of Colombo, and SMEs led by women. They will gain more access to finance to fund working capital and expand their businesses. Furthermore, participating financial institutions (PFIs) will expand their customer base and gain experience in lending to unconventional SME clients.

3. **Impact channels.** The project will (i) increase access to finance for SMEs in Sri Lanka; (ii) contribute to diversifying the economy through an increased SME share in gross domestic product; and (iii) create employment especially for new SME borrowers, SMEs without collateral, SMEs outside of Colombo, and SMEs mainly owned or managed by women.

4. **Design features.** The project is an additional \$75 million to the \$100 million financial intermediary loan. The government will be the borrower and will relend the loan to PFIs; the PFIs will then onlend to eligible SME subprojects. The subloan tenor will not exceed 10 years. At least 50% of the subloans must cumulatively be lent to targeted SMEs, which include SMEs that are (i) located outside of Colombo, (ii) borrowing for working capital against which fixed or financial assets are not pledged, (iii) led by women, or (iv) borrowing for the first time from a licensed commercial or specialized bank. At least 20% of subloans must be to SMEs owned or led by women.

II. PARTICIPATION AND EMPOWERING THE POOR	
<p>1. Participatory approaches and project activities. Key stakeholder groups in government (i.e., Ministry of Finance and Mass Media, Central Bank of Sri Lanka, Credit Information Bureau, and Export Development Board), financial institutions, and civil society (Federation of Chambers of Commerce and Industry) were consulted in the preparation of the project design. A steering committee comprising representatives of government and ADB oversees project implementation.</p> <p>2. The following forms of civil society organization participation are envisaged during project implementation, rated as high (H), medium (M), low (L), or not applicable (NA): <input checked="" type="checkbox"/> Information gathering and sharing (M) <input checked="" type="checkbox"/> Consultation (M) <input checked="" type="checkbox"/> Collaboration (M) <input type="checkbox"/> Partnership (NA)</p> <p>3. Participation plan. <input type="checkbox"/> Yes. <input checked="" type="checkbox"/> No. A gender action plan was prepared for the engagement of networks of female entrepreneurs.</p>	
III. GENDER AND DEVELOPMENT	
Gender mainstreaming category: effective gender mainstreaming	
A. Key Issues	
<p>The low female labor participation rate of 39% suggests a large pool of untapped human resources for national economic development.^g In addition, the unemployment rate for women is higher by 17.0 percentage points than for men.^h A potential measure is to support women's greater involvement in SMEs. Data from the Ministry of Rural Economic Affairs shows that women comprise 24.8% (252,915) of the 766,766 entrepreneurs. According to the Women's Chamber of Industry and Commerce, female entrepreneurs are confronted by four key challenges: (i) lack of skills and cultural barriers to start and run a business, and dependence on husbands for financial support; (ii) lack of access to markets and information on market needs, and difficulties in finding new markets for products; (iii) lack of access to finance because of low financial literacy and lack of collateral for bank loans; and (iv) weak government institutional support.</p>	
B. Key Actions	
<input checked="" type="checkbox"/> Gender equality and social inclusion action plan <input type="checkbox"/> Other actions or measures <input type="checkbox"/> No action or measure Capacity development technical assistance (TA) was provided with the original loan and is still under implementation to strengthen female entrepreneurship especially in three areas (information and communication technology [ICT], fruits and vegetables, and processed food and beverage). Interventions will be in two areas: (i) Support for women entrepreneurs in the targeted export-oriented clusters in business development and management (including financial literacy). The TA activities include (a) conducting a gender-responsive value chain analysis of the three targeted areas, and developing a strategy for expanding and strengthening female entrepreneurship therein; (b) providing business development services to women entrepreneurs as per the recommendations of the analysis; and (c) strengthening networks of women entrepreneurs. (ii) Increasing the awareness of careers in ICT and business process outsourcing (BPO) among young women in high school and early college as a way to (a) increase their participation, (b) build the total workforce to meet future demand, and (c) maintain Sri Lanka's future competitiveness. The TA activities involve (a) identifying economic, social, and regulatory barriers, including the economic impact of laws that prevent women from working at night and prohibit them from entering and staying in ICT-BPO, and developing a sector strategy to attract female workers; (b) developing, implementing, and operationalizing awareness-raising programs and campaigns for female participation in ICT-BPO in partnership with education institutions; (c) providing support for school career counselors to build strong networks of ICT-BPO professionals; and (d) launching a career forum for female students with interest in ICT-BPO.	
IV. ADDRESSING SOCIAL SAFEGUARD ISSUES	
A. Involuntary Resettlement	
<p>Safeguard Category: <input type="checkbox"/> A <input type="checkbox"/> B <input type="checkbox"/> C <input checked="" type="checkbox"/> FI</p> <p>1. Key impacts. The project will not trigger involuntary resettlement because during subproject selection the PFIs will reject all subprojects with potential involuntary resettlement impacts.</p> <p>2. Strategies to address the impacts: none.</p> <p>3. Plan or other actions: <input checked="" type="checkbox"/> Environmental and social management system arrangements.</p>	
B. Indigenous Peoples	
<p>Safeguard Category: <input type="checkbox"/> A <input type="checkbox"/> B <input type="checkbox"/> C <input checked="" type="checkbox"/> FI</p> <p>1. Key impacts. <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No</p> <p>2. Strategies to address the impacts: none</p> <p>3. Plan or other actions. <input checked="" type="checkbox"/> Environmental and social management system arrangement</p> <p>Subproject selection criteria exclude all subprojects with any potentially detrimental impacts on indigenous peoples.</p>	

V. ADDRESSING OTHER SOCIAL RISKS
<p>A. Risks in the Labor Market</p> <p>1. Relevance of the project for the country's or region's or sector's labor market, indicated as high (H), medium (M), and low or not significant (L). <input checked="" type="checkbox"/> unemployment (H) <input type="checkbox"/> underemployment <input type="checkbox"/> retrenchment <input type="checkbox"/> core labor standards</p> <p>2. Labor market impact. The project is expected to increase access to finance for SMEs that are outside of Colombo, have not previously borrowed from a licensed commercial or specialized bank, and are owned or led by women. The PFIs will be directed to inform the SME borrowers about labor rights issues, core labor standards, and the requirement to comply with the standards.</p>
<p>B. Affordability</p> <p>The incentives for the line of credit must be carefully calibrated so that the PFIs extend credit to the targeted SMEs and not to SMEs that already have secure access to finance. The line of credit will include an auction mechanism to allow PFIs to recover the higher operating and credit costs of extending credit to the targeted SMEs.</p>
<p>C. Communicable Diseases and Other Social Risks</p> <p>1. The impact of the following risks are rated as high (H), medium (M), low (L), or not applicable (NA): <input type="checkbox"/> Communicable diseases (NA) <input type="checkbox"/> Human trafficking (NA)</p> <p>2. Risks to people in project area: none.</p>
VI. MONITORING AND EVALUATION
<p>1. Targets and indicators. The project outcome will also be improved access of SMEs to finance. Target indicators specifically designed to contribute to poverty reduction and social inequity are (i) 70% of the subloans must cumulatively be lent to targeted SMEs, which include SMEs that are (a) located outside of Colombo, (b) borrowing for working capital against which fixed or financial assets are not pledged, (c) led by women, or (d) borrowing for the first time from a licensed commercial or specialized bank; and (ii) 15% of subborrowers must be SMEs owned or led by women. Details can be found in the revised design and monitoring framework and gender action plan. A target output indicator of the attached TA project is the strengthened capacity of female entrepreneurs.</p> <p>2. Required human resources. The Ministry of Finance and Mass Media is the executing agency for the TA. Its Department of Development Finance is the implementing agency for component 1 of the TA and the Export Development Board the implementing agency for component 2 of the TA. ADB has recruited international and national consultants in support of the TA. International consultants include three value chain development experts (one for each of the three areas) and an expert on female entrepreneurship. National consultants include experts on female entrepreneurship, capacity development, and research and documentation. The Sri Lanka Resident Mission's social development specialist is monitoring implementation of the gender action plan.</p> <p>3. Information in the project administration manual. All project features pertaining to social inclusion and gender are included in the project administration manual (section VIII).</p> <p>4. Monitoring tools. To monitor and evaluate the progress and results of the social and gender features of the project (both loan and attached TA), output and outcome indicators are being monitored quarterly and presented through quarterly progress reports, with a gender action plan implementation-update matrix attached. Review missions will monitor the timely and effective implementation of the project-specific gender action plan.</p>

^a ADB. 2017. *Country Operations Business Plan: Sri Lanka, 2018–2020*. Manila.

^b Sri Lanka 2017 budget speech delivered on 10 November 2016. Ministry of Finance and Mass Media, Sri Lanka. Budget Speeches. <http://www.treasury.gov.lk/budget-speeches>.

^c ADB. 2008. *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila and ADB. 2017. *Country Partnership Strategy: Sri Lanka, 2018–2022—Transition to Upper Middle-Income Country Status*. Manila.

^d ADB. 2017. *Basic 2017 Statistics*. Manila.

^e Government of Sri Lanka, Department of Census and Statistics. 2017. *Quarterly Report of the Sri Lanka Labour Force Survey*. Colombo.

^f World Economic Forum. 2014. *The Global Gender Gap Report 2014*. Geneva.

^g K. Attygale et al. 2014. *Female Entrepreneurship and the Role of Business Development Services in Promoting Small and Medium Women Entrepreneurship in Sri Lanka*. Sri Lanka: Institute of Policy Studies and Oxfam International.

^h ADB. 2016. *Key Indicators for Asia and the Pacific 2016*. Manila.