

INITIAL POVERTY AND SOCIAL ANALYSIS

Country:	Sri Lanka	Project Title:	Small and Medium-sized Enterprises Credit Guarantee Institution
Lending/Financing Modality:	Novel Financing Arrangement	Department/ Division:	South Asia Department/ South Asia Public Management, Financial Sector and Trade Division

I. POVERTY IMPACT AND SOCIAL DIMENSIONS

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

The proposed project aligns with one of the three pillars of ADB's 2015-2016 country partnership strategy—catalyzing private investment and enhancing the effectiveness of public investment— and is a natural extension of a recently approved \$100 million ADB credit line that targets under-served SMEs such as those located outside Colombo, women entrepreneurs and new clients. With its support to SMEs that lack collaterals to access loans, the proposed credit guarantee institution will also address issues of sustained regional disparities.

The proposed project is aligned with the government's Budget Speech 2017 which aims to *inter alia* accelerate economic growth, improve access to finance and address low private sector investment.

B. Poverty Targeting

General Intervention Individual or Household (TI-H) Geographic (TI-G) Non-Income MDGs (TI-M1, M2, etc.)

This proposed project is expected to form a credit guarantee institution targeting SMEs in Sri Lanka, with a special focus on borrowers without collateral. This support is likely to benefit underserved constituencies, which are generally constrained by their ability to provide collateral, such as (i) new SMEs; (ii) lower income areas outside of Colombo, including in the post-conflict areas in the Northern and Eastern provinces; and (iii) women led SMEs.

C. Poverty and Social Analysis

1. Key issues and potential beneficiaries. Although Sri Lanka has been able to reduce the share of the population below the official poverty line (\$1.48/day) to 6.7% by FY2012/13, regional development disparities have subsisted. While the Western Province, which includes Colombo and which has the highest per capita income, recorded the lowest poverty incidence of less than 3% in FY2012/13, the Northern District recorded 12.8% and the Eastern District recorded 14.8% in the same year. The primary beneficiaries of the project are SMEs. Supported by credit guarantee, they will gain more access to finance to fund working capital and expand their businesses. Furthermore, financial institutions (FIs) will expand their customer base and gain experience in lending to unconventional SME clients.

2. Impact channels and expected systemic changes. The impact will be increased employment opportunities aligned with government policy. 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) result in employment creation especially for SMEs without collateral.

3. Focus of (and resources allocated in) the PPTA or due diligence. A capacity development technical assistance (CDTA) attached to the \$100 million ADB credit line examined the feasibility of a credit guarantee framework for SMEs in Sri Lanka with the intention to improve the access of SMEs to institutional finance. Banks are hesitant to lend to SMEs in the absence of collateral. As a result, SMEs have to either forego borrowing and compromise on growth or they are forced to access finance at exorbitant rates from moneylenders. The proposed credit guarantee institution is expected to bridge this gap and make institutional finance accessible to such borrowers at a reasonable guarantee fee. The CDTA study has recommended the formation of a dedicated nonbank financial institution for this purpose that will leverage support from ADB to access private capital. Thus, financing is a mix of public and private. The institution would begin with a capital base of \$56.1 million funded. In order to maintain a rating of AA-, the institution would initially leverage its capital only 1.5 times. Therefore, the original \$56.1 million of paid-in capital funded approximately 95% from the government and 5% from the institution's likely clients would support \$84 million of guarantees.

II. GENDER AND DEVELOPMENT

1. What are the key gender issues in the sector/subsector that are likely to be relevant to this project or project? Promoting and supporting women-led SMEs is also considered as a response to the national problem of low female

labor force participation rate of 35% despite higher female literacy rate (98.6% for females, and 97.7% for males) and gender parity in education. Employment is a significant area in which women face inequality and gender discrimination. Most enterprises that are owned or managed by women are micro- and small-sized and face limited access to finance because they cannot offer collateral, do not have the skills to apply for formal financing, or do not maintain the necessary business records. The credit guarantee institution will improve access to such SMEs that are owned by women.

2. Does the proposed project have the potential to make a contribution to the promotion of gender equity and/or empowerment of women by providing women's access to and use of opportunities, services, resources, assets, and participation in decision making?

Yes No The proposed project will empower women through (i) better access to institutional sources of finance and (ii) better employment opportunities in the SME sector. Due diligence will also explore using the proposed attached TA to offer new services including business development services to women-owned SMEs that are clients on the institution.

3. Could the proposed project have an adverse impact on women and/or girls or widen gender inequality?

Yes No

4. Indicate the intended gender mainstreaming category:

GEN (gender equity) EGM (effective gender mainstreaming)
 SGE (some gender elements) NGE (no gender elements)

III. PARTICIPATION AND EMPOWERMENT

1. Who are the main stakeholders of the project, including beneficiaries and negatively affected people? Identify how they will participate in the project design.

The key stakeholders are (i) the Government of Sri Lanka, (ii) the Central Bank of Sri Lanka, (iii) banks and financial institutions, and (iv) SMEs. The main beneficiaries are SMEs without collateral—a segment currently deprived of access to institutional finance. There are no negatively affected people. The decision to create the credit guarantee institution is based on a demand analysis that was conducted in consultation with SMEs, chambers of commerce, entrepreneur societies, and branches and regional offices of financial institutions in Sri Lanka.

2. How can the project contribute (in a systemic way) to engaging and empowering stakeholders and beneficiaries, particularly, the poor, vulnerable and excluded groups? What issues in the project design require participation of the poor and excluded?

The project design does not require direct participation of the poor and excluded. However, the outreach plan will have to consider what limitations financial institutions face in lending to un- or under-banked SMEs.

3. What are the key, active, and relevant civil society organizations (CSOs) in the project area? What is the level of CSO participation in the project design?

(L) Information generation and sharing (L) Consultation Collaboration Partnership

They key civil society organizations are the chambers of commerce including the Federation of Chambers of Commerce and Industry, which focuses more on SMEs than the other chambers, and the Women's Chamber of Industry and Commerce.

4. Are there issues during project design for which participation of the poor and excluded is important? What are they and how will they be addressed? Yes No

IV. SOCIAL SAFEGUARDS

A. Involuntary Resettlement Category A B C FI-C

1. Does the project have the potential to involve involuntary land acquisition resulting in physical and economic displacement? Yes No

2. What actions are required to address involuntary resettlement as part of the PPTA or assessment process? N/A
 Project safeguard system assessment and actions None

B. Indigenous Peoples Category A B C FI-C

1. Does the proposed project have the potential to directly or indirectly affect the dignity, human rights, livelihood systems, or culture of indigenous peoples? Yes No

2. Does it affect the territories or natural and cultural resources indigenous peoples own, use, occupy, or claim, as their ancestral domain? Yes No

3. Will the project require broad community support of affected indigenous communities? Yes No

4. What actions are required to address risks to indigenous peoples as part of the PPTA or the project assessment process?

Project safeguard system assessment and actions None

V. OTHER SOCIAL ISSUES AND RISKS

1. What other social issues and risks should be considered in the project design?

Creating decent jobs and employment Adhering to core labor standards Labor retrenchment
 Spread of communicable diseases, including HIV/AIDS Increase in human trafficking Affordability (L)
 Increase in unplanned migration Increase in vulnerability to natural disasters Creating political instability
 Creating internal social conflicts Others, please specify _____

The cost of guarantees must be carefully calibrated so that the SMEs are encouraged to employ them in raising loans. Similarly, the benefits need to reach underserved SMEs and not only SMEs that already have secure access to finance.

2. How are these additional social issues and risks going to be addressed in the project design?

The institution's capital base will be subsidized so that it can provide guarantees at below the risk-adjusted price.

VI. PPTA OR ASSESSMENT RESOURCE REQUIREMENT

1. Do the terms of reference for the PPTA (or project assessments) contain key information needed to be gathered during PPTA or the project assessment process to better analyze (i) poverty and social impact; (ii) gender impact, (iii) participation dimensions; (iv) social safeguards; and (v) other social risks. Are the relevant specialists identified?

Yes No

The proposed project entails limited poverty and social issues. One person month of input from a safeguard officer and a social development officer respectively is envisaged for project preparation.

2. What resources (e.g., consultants, survey budget, and budget for workshop(s)) are allocated for conducting poverty, social and/or gender analyses, and participation plan during the PPTA or the project assessments?

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